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MANUFACTURING ENTERPRISES IN THE GAZA STRIP:
Case Studies in Production Under Extreme Regulatory Restrictions.

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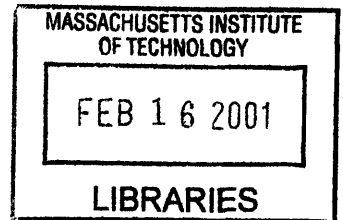
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Submitted to the Department of Urban Studies and Planning
and the Department of Architecture on May 10, 1991
in partial fulfillment of the requirement for the degrees of
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ABSTRACT:

The situation in the occupied territories is distinguished from other cases of authoritarian, colonial or even military rule by the high level of consistency and the wide range of administrative levels at which the occupying power has been able to implement its restrictive policies. This regulatory framework has remained flexible, expanding in scope of coverage and consistency of implementation throughout the years of occupation, guided by shifts in Israeli policy and the intensity of rejection and the pattern of response by the Palestinian population.

Palestinian manufacturing firms that were initiated and functioned within this framework were molded by its limiting guidelines and plagued by the vulnerabilities it promoted. All their activities had to comply with Israeli policy, pose no real threat to Israeli producers or contribute effectively to a viable local process of economic development. Most of these firms evolved in a few less restricted subsectors and engaged in rigid production processes that specialized in the mass production of a limited range of consumer goods. Some of the firms that were initiated outside this framework, but eventually forced to function within it as a result of intensified surveillance of informal activities, were able to develop an independent foundation, flexible production processes and links with the local and Israeli economies.

The advent of the Palestinian uprising in 1987 brought with it a further intensification of the regulatory framework that bordered on the virtual obstruction of economic activities in the territories. This situation placed the two broad firm categories under a serious test of survival. Firms within the two categories were left with the choice of functioning within the new obstructive regulatory framework and maintaining some access to formal sources of raw materials, machinery and technological transfer which could only be obtained from or through Israeli sources, or of functioning outside the system and remaining physically confined to an obstructed local economy.

The goal of this thesis is three-fold: first, to identify the governmental and non-governmental components of this regulatory framework and shed light on their functions and the reasons behind their effectiveness; second, to discuss the impact of this regulatory framework on the structure and characteristics of local firms that were initiated and functioned within it and others that were initiated outside; third, to compare the response and the level of success or failure of firms within the two categories to shifts in policy as well as to the changes of economic and political conditions during the years of the Palestinian uprising.

Thesis Supervisor: Lisa Peattie
Title: Professor Emeritus of Urban Anthropology

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I dedicate this thesis to the steadfast people of Palestine and to the memory of my father, Rashad Shawa. His dreams will be with me forever.

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I - INTRODUCTION:

1.1- Introduction.

1.2- Case Studies:

- . Subsector Selection.

- . Firm Selection.

1.3- The Data Collection Process.

1.4- Description of Chapters.

INTRODUCTION:

The Israeli occupation of the West Bank and Gaza Strip has affected all aspects of life in these territories. Not only did Israel colonize the land and water resources of the two territories and deny their inhabitants political and human rights, but it also colonized their economies. Israel restructured these economies so that it could reap the comparative advantages of each for its own benefit.¹ It systematically increased the level of their economic dependence on the occupying state and obstructed their direct access to the outside world. During the years of the Palestinian uprising, Israeli policy toward the two territories shifted, altering the nature of the relationship. After having converted the two territories into totally dependent entities and tightly regulating their economic activities to guarantee the comprehensive transfer of economic benefits to the Israeli economy, the Israeli authorities began obstructing their most vital links with the Israeli economy and constricting all their economic activities. The new policies have contributed to the gradual attrition of local economic institutions and the further isolation of the two territories from the outside world.²

This thesis will investigate the individual experiences of Palestinian manufacturing enterprises in coping with Israeli restrictive regulations, adverse market conditions and a volatile political situation. I will use the findings of this research to lay the foundation for two areas of study that will be conducted after the completion of this work. The first is to identify the potential areas for intervention during this phase of occupation. The second is to explore the relevance of the experiences of the firms interviewed to firms functioning under restrictive conditions as well as the contribution of this study to the discussions on development and industrial restructuring. The research in this thesis is based on data derived from interviews that were conducted with owners of ten manufacturing enterprises in the Gaza Strip within two subsectors: textiles and basic metal products. The study was confined to firms in the Gaza Strip, but occasional reference will be made to the West Bank because of the similarity of conditions, restrictions and firm experiences in both territories. The lack of research on the conditions of local manufacturing firms in the Gaza Strip and the problem of mobility between

¹ Aziz Al-Dweik, "Self-Selection and Spatial Mobility of Palestinian Male Workers in the West Bank and Gaza Strip" (Ph.D. diss., University of Pennsylvania, 1988), 24.

² The per capita GNP of the inhabitants Gaza Strip has declined from \$1700 to \$1200 which represents a decline of more than 30% during the years of the uprising. Sara Roy, "The Political Economy of Despair: Changing Political and Economic Realities in The Gaza Strip," *Journal of Palestine Studies* 79 (Spring 1991): 61.

the two territories during the period that the research was conducted were the main reasons behind concentrating on the Gaza Strip.

Several studies have appeared about the impact of the Israeli occupation on the economies of the West Bank and Gaza Strip. For the most part, they have concentrated on identifying the macro level economic patterns resulting from the restrictive Israeli policies.³ This type of analysis has been applied to studies of the economy as a whole, as well as of patterns of development in each of its sectors.⁴ These studies have discussed the economic indicators that reflect the total dominance by the Israeli economy over its Palestinian counterpart and the poor performance of the local productive sectors. They have identified the general obstacles to the development of the economy as a whole and its productive sectors and have analyzed the Israeli policies and economic conditions that have contributed to shaping the local economy and have resulted in restricting its overall growth. They described the contribution of the various sectors of the local economy and the general problems confronting the growth of each particular sector. These studies have therefore concentrated on identifying the outcome and to a lesser extent the policies that were used to create it but not the dynamic processes that this pattern is only a generalized summation of. Some studies have been based on surveys, usually conducted by local Palestinian institutions, of firms within the Palestinian industrial sector.⁵ These studies have gone further than the more general analyses toward identifying the impact of Israeli policies and adverse economic conditions on the formation of firm categories and the overall performance of certain subsectors.

The existing studies of the pattern of economic development in the occupied territories and the restrictive Israeli policies that have shaped these patterns and have provided an overall picture that exposes the devastating effectiveness of these policies. However, there are several questions about the experiences of local firms at the micro level that these studies have addressed in only limited fashion. How did local firms confront Israeli restrictions, and what

³ Fawzi Gharaibeh, *The Economies of the West Bank and Gaza Strip*, (Boulder/London, 1985). Meron Benvenisti, *1986 Report: Demographic, Economic, Legal, Social and Political Development in the West Bank*, (Boulder, Colorado, 1986). George Abed, *The Palestinian Economy*, (London, 1988).

⁴ Bakir Abu-Kishk, *Arab Industry in the Occupied Territories*, (Jerusalem, 1981) Translated title (Arabic). Simcha Bahiri, *Industrialization in the West Bank and Gaza*, (Boulder, Colorado, 1987).

⁵ Hisham Awartani, *A Survey of Industries in the West Bank and Gaza Strip*, (Birzeit, West Bank, 1979) Hind Kattan Salman, *Manufacturing in the Bethlehem Area: a Survey of Manufacturing Industries in Bethlehem, Beit Jala and Beit Sahour on the West Bank*, (Jerusalem, 1990). Elias Tuma and Samir Hazboun, "Industrialization in the Occupied Territories, a Local Perspective," (Bethlehem,).

determined their success or failure in doing so? How were some firms able to bypass restrictions? Whether local firms functioned inside or outside the regulatory framework, what were the vulnerabilities of the systems they devised to cope with restrictions? What were the vulnerabilities of their dependent relationships with Israeli producers, importers of raw materials and machinery, and retailers? Even the studies based on surveys have not fully addressed these questions at the firm level, due, in part, to Israeli restrictions on the research of local and external institutions, but also to data collection procedures which relied on very general, standardized questionnaires, and to the concern of local firms that their activities would be exposed to Israeli authorities.

The goal of this thesis is to address some of these gaps and to construct a detailed picture of the economic situation in the territories which is based on experiences of firms and not derived from macro level economic indicators. My findings provide more evidence, at the level of the firm, of the processes which create the patterns that those other studies have traced. They also may explain some inconsistencies that occur within this overall pattern. Furthermore, the individual experiences of the few firms that have bypassed the extensive obstacles and the vulnerabilities of the ones that failed could identify opportunities for effective intervention.

Interventions by local and international organizations and recommendations by economists aimed at promoting the development of the Palestinian productive sectors have relied heavily on the findings of the general studies discussed above. Many of the interventions by these organizations have been misguided, advocating solutions that do not address the main requirements of local firms. They have tended to select the easiest but most expensive solutions: for example, some have focused on providing credit, although credit does not seem to be the main problem, while others have avoided the difficult task of dealing with existing firms which would require more complex interventions, and have focused instead on funding new and untested firms. The lack of communication between these organizations and existing local firms is primarily responsible for the gap in information available about the difficulties confronted at the firm level and the real impact of Israeli policies. Most of these organizations have not capitalized on the wide range of experiences of local firms. Economists have also suggested traditional interventions such as enhancing the firm's access to credit, export markets, or the establishment of new and hopefully more viable productive projects. Since

most of these recommendations clash directly with Israeli policy, their implementation could not be allowed unless there is a major change in the political situation, loosening the Israeli grip over the territories. Moreover, many recommendations have concentrated on the prospects for the development of and the viability of a future Palestinian state, and have thus completely bypassed addressing the current situation. They recognize the difficulty of the current situation and the unfeasibility of most of the traditional recommendations, and address the next phase instead. The problem of this approach is that it bypasses one of the main themes of the Palestinian uprising which calls for the building, during this transitional phase, of an economic, social and institutional foundation in preparation for independence.

Another goal of this thesis, therefore, is to explore an alternative level for intervention through the analysis of the experiences of individual firms. This approach could provide local and international organizations with a wider and more grounded range of intervention possibilities to be conducted during the current phase of occupation. The first level of intervention is addressing the particular technical, financial and administrative requirements of individual firms, firm categories and subsectors. The second level is addressing the vulnerabilities of the systems devised by local firms to deal with Israeli and international economic sectors. The third is addressing the vulnerabilities in the system devised by local firms for dealing with the government imposed regulatory framework.

The conditions confronting Palestinian firms operating in the occupied territories are very unique. However, their experience in operating under a set of particularly obstructive governmental policies, extremely limiting economic conditions and a volatile political situation, could provide lessons which could be generalized for firms functioning under other restrictive conditions. The pattern of response of local firms to these policies could provide a testing ground for many concepts in the wider realm of academic and theoretical discussion. All firm categories within the two territories are undergoing an extreme test of their capability to survive these adverse conditions. Formal and informal firms, mass producers and flexible specialists, small and large and subcontracting firms have evolved. They responded to these conditions in distinctive ways and have experienced varying levels of success or failure.

The third goal of this thesis is to identify the nature of the responses adopted by the different firm categories and the reasons behind their success or failure. Through this analysis, I would like to determine whether under these conditions, the character of the production

process (flexible vs. rigid) could be considered as one of the main factors determining the firm's ability to succeed or fail. I would also like to investigate the relationship between the firm's status (formal or informal) and the level of its potential confrontations with the regulatory framework on the one hand, and the character and the evolution of its production process on the other.

1.2 CASE STUDIES:

I have selected ten manufacturing firms in two subsectors, five in the production of textile/clothing and the other five in basic metal products. Through the study of the functioning of this series of firms, I will identify the impact of the macro and micro level policies on their activities. I will illustrate the system of linkages devised by each individual firm to bypass the restrictive policies and compensate for the institutional support gap and thus gain access to markets, inputs, technology transfer, credit and labor. I will also illustrate the changes in this system of linkages in response to changes in Israeli policies and their intensity of implementation during the initial twenty years of occupation, as well as changes that occurred during the years of the Palestinian uprising. The sample I have selected and the data that will be generated from this sample might not allow generalization, but will provide insight into the mechanics of the different possible adjustments adopted by firms in response to a set of general policies and conditions.

Subsector Selection:

- Each of the two subsectors has a unique relationship with the Israeli regulatory framework. Textiles has been a less restricted subsector than Basic metal. For that reason, firms within each subsector reflect a different growth pattern which is closely shaped by their relationship with the authorities.⁶
- Both subsectors have achieved a considerable level of growth during the initial 20 years of occupation becoming the two largest manufacturing subsectors in the territories. By 1987 textile firms represented 26.1% (1080) of the total number of firms in both territories and

⁶ The character of firms within the two categories are markedly different. Basic metal product firms tended to start out with small-scale, informal production activities, while most textile firms began as formal firms with rigid production processes. However, both firm categories were forced to function within the formal realm at the later stages of the occupation

employed 42.9% (6,098) of the locally employed labor force while 24.7% (1018) of all firms were in basic metals, employing 18% (3,068) of that labor force.⁷ This level of growth is attributed to the development of formal and informal links to the Israeli economy and its subsectors, in the form of subcontracting arrangements (in the case of textiles) and informal as well as formal access to Israeli and local markets (in the case of basic metal products).

- In response to the collapse of most formal and informal links with the Israeli economy and the decline in local consumption during the years of the uprising, both subsectors underwent an extensive restructuring process. The wide range of alternative responses adopted by firms in both subsectors during this period could represent an attempt by local firms to construct the initial stages of a new system of linkages based on local demand and a limited reliance on the vulnerable and politically undesirable links with the Israeli economy. The various successful or failed attempts by firms in these two subsectors could thus provide a diverse, subsectoral analysis map identifying areas of possible intervention by local and international non-governmental organizations.

- Some firms within both categories have adopted both flexible and rigid production processes and have responded to changes in Israeli policy and deteriorating economic conditions in different ways. Firms within both categories entered into mass production but the character of their lines of production developed in distinctive ways.

- Both subsectors have achieved a considerable level of technical advancement in their production processes. This is seen to be the outcome of links with Israeli productive subsectors and through them with foreign sources of technological transfer and suppliers of high-tech machinery and equipment. The flexible character of the production processes employed by basic metal product firms has allowed a wide range of experimentation and ingenuity as firms responded to market challenges and obstruction by the authorities. This level of technical advancement could help achieve a comparative advantage for local firms and a sustainable future access to export markets if and when an institutional framework of support capable of providing direct export links is established.

⁷ Peter Sadler, "Brief Overview of the Investment Opportunities in the Occupied Territories and Possibilities for Future Development," prepared for a UNIDO Seminar on Prospects for the Palestinian Industrial Sector. (Vienna, October 1989) 7.

Firm Selection:

I used a survey done by a local private voluntary organization on all manufacturing establishments in the Gaza Strip for the selection of my ten cases.⁸ This survey was prepared in 1986 for a proposed funding program sponsored by the Jordanian Palestinian Joint Committee to be administered by this local organization. The program was never implemented but the information in the survey was updated during the initial years of the uprising to be used for future funding of production activities.

The firms I selected were of various sizes with the number of employees ranging from 5 to 100 before the uprising; however, a drastic decline in this number was witnessed during the years of the uprising. Fixed capital investment per firm ranged from \$10,000 to \$1.5 million. Before the uprising, most of the larger firms selected were located in industrial areas or on main external arteries within the Gaza Strip, while the smaller ones were located in residential as well as commercial/industrial areas. During the uprising, most firms relocated to residential neighborhoods, in many cases to the neighborhood of residence of the owner but in some cases to other residential areas with a cheap or locally available labor supply. Usually, the relocation was done to reduce costs (in the case of relocating to existing commercial units within the extended family residence or other existing suitable structures), to avoid army and taxation raids which are more likely to take place in commercial/industrial districts and to avoid work stoppage during curfews or strikes as a result of travel difficulties that could be experienced by the labor force and owner. The firms I selected reflected various levels of success or failure in responding to the recent changes.

The responses adopted by the different firms within this sample to the new conditions introduced during the uprising could be considered representative of the types of responses adopted by other firms in the same subsector and, to a certain extent, by firms in other subsectors of the local Palestinian economy. The success or failure of these responses and the factors that contributed to such results could also be considered representative of the factors that played the main role in shaping such results for other firms within or outside these subsectors.

⁸ Benevolent Society for the Relief of the Gaza Strip inhabitants.

1.3 DATA COLLECTION:

At the initial stages, I selected 15 firms and went on field visits to each accompanied by an official of the local organization who had previous contact with some of the firm owners. During this first visit I had the opportunity to explain the purpose of my study and make sure that they understood that I did not represent any local or international organization and most importantly, to assure firm owners that their interviews would not fall in the hands of the Israeli authorities. The firm owners, on the other hand, explained briefly their production activity and gave us a general review of the difficulties they are confronting and the opportunities they saw.

After this visit, I was able to arrange an average of three sessions per firm. The first was an informal discussion session about the history of the firm and its owner, a more detailed description about the production activity, the changes that the firm went through during the uprising, the difficulties confronted and the responses to such difficulties. The second session was a more formal discussion based on a questionnaire I prepared concentrating on identifying the system of linkages established by the firm relative to markets, inputs, labor, credit, technical transfer and institutional support. The third was an informal session characterized by a higher level of directness, where views about local institutions, other firms, visions of a process of development and definitions of such a process, were shared by the industrialist. I also had the opportunity to attend some informal discussion gatherings with groups of young industrialists from various subsectors comparing notes on their situations and discussing general conditions confronting their production activities. These gatherings provided me with valuable insights into a series of issues: bureaucratic procedures and dealing with governmental regulations, tax collection procedures, characteristics of links to sources of inputs, machinery and technical transfer opportunities, characteristics of local markets, relations between producers and retailers and views about the functions of local organization.

1.4 DESCRIPTION OF CHAPTERS:

The second and third chapters of this thesis function as introductory chapters and will provide a background on the impact of the occupation on the general structure of the industrial sector as well as provide a description of the Israeli structure of control. Chapter two will provide a general statistical background on the Gaza Strip. It will discuss the phases of the occupation period, the shifts in Israeli policies, changes in economic conditions, and their

impact on the Palestinian industrial sector and the character of firms within it. It will also discuss the implications of Israeli policies to finance, access to markets, labor, technology transfer and raw materials and the shaping of the non-governmental institutional structure that exist in the Gaza Strip. Chapter three will discuss in more detail the Israeli system of governance in the Gaza Strip and the various components of the regulatory framework that are in charge of implementing the occupation policies.

Chapter four will describe the ten selected case studies. It will identify the the phases of Israeli occupation relative to the experiences of the firms and their pattern of development and the structural changes that they went through as a result of shifts in Israeli policies and macro-level changes in economic conditions. The discussion will be based on the data derived from the case studies and will reflect the experiences and responses of the selected firms to the above mentioned changes. This chapter will identify the impact of the Israeli policy and the method of its enforcement at the level of the firm. It will also identify the character of the evolving patterns of production processes adopted and developed by these firms in response to the implemented policies and their impact on the specific conditions under which these firms had to function.

Chapter Five will discuss in detail the system of operation that the various categories of firms within the selected sample have adopted. It will identify how the enforced policy shaped this system and will describe its areas of vulnerability and innovation. This chapter will therefore describe the approach adopted by the various firm categories to gain access to markets, raw materials, credit, machinery, technology transfer, labor and the factors that influenced firm location decisions. All discussions will be based on the experience of the individual firms and will thus identify the impact of the general Israeli policy at the firm level and the consistency of its enforcement.

Chapter six will represent the summary of findings and will discuss the distinctive characteristics of the conditions under which firms in the occupied territories function based on the experience of the various firm categories and the responses they have adopted. It will identify the distinctive bargaining conditions facing firms and the extent to which these firms are able to bypass the extensively enforced Israeli policies. This discussion will identify the areas of similarity and difference of these responses compared to small firms under disadvantageous conditions elsewhere. It will redefine the concept of informality under such

conditions and the reasons behind its adoption by local firms. It will also examine the distinctive barriers that are present for these local firms in both realms of activity, formal and informal. This section will indicate that the functions of the selected firms are very similar to those of other small firms in different settings but will discuss why certain decisions that are made by these firms are usually made for different reasons and as an outcome of a different set of conditions. It will examine the attitude of the local firms to the familiar types of production processes such as mass production and flexible specialization and will identify the distinctive reasons behind their adoption. This section will also discuss the performance of flexible vs. rigid production processes during the shifts in Israeli policy and the deterioration in economic conditions. It will identify the firms' qualities that contributed to their success or failure in adjusting their production processes in response to such shifts.

The final chapter will discuss the three directions that this thesis will pave the way for in preparation for further research. The first area is a discussion of the conditions that have developed in the territories as an outcome of the Israeli restructuring and gradual obstruction of the two local economies and their productive sectors. The second area is a discussion of the possible areas for intervention that are required during this phase in preparation for a more positive future phase or an enhanced ability to confront the increasingly restrictive Israeli policies. The third area is a discussion of the value and relevance of the experiences of Palestinian firms in confronting a particularly obstructive regulatory framework, a set of adverse economic conditions and a volatile political situation for firms that function under similar adverse conditions and for a wider body of knowledge on related topics.

I felt that the definition of development that these firms aspired to and the pattern of intervention required to initiate it, had more to do with protection from the Israeli system and the introduction of legal limitations on authorities against implementing their brutal policies. The main request was not for low-cost credit or unrestricted access to raw materials, technology transfer, and machinery, but rather for the introduction of an indigenous protective institutional structure that had the required international backing to check the free and unrestricted Israeli hand over the life of people, their resources and their socio-economic activities.

II - IMPACT OF ISRAELI OCCUPATION:

2.1- Statistics (The Gaza Strip).

2.2- Outcome of Twenty Years of Occupation.

2.3- Phases of the Occupation Period.

2.4- Areas of Control:

- . Finance
- . Markets
- . Raw Materials / Machinery
- . Labor
- . Institutions

2.1 STATISTICAL BACKGROUND: THE GAZA STRIP.

After the war of 1948, 97.5% of the original area of the Gaza Province was lost to the newly established state of Israel. After the Armistice Agreement of 1949 between Egypt and Israel, the remaining area was recognized as a separate entity and was placed under Egyptian administration and named the Gaza Strip. The area of the Gaza Province prior to 1948 was 13,688,501 dunums (51% of the total land area of Mandatory Palestine), and by 1947 had a population of 303,500 (11% of the total population of Palestine at the time).⁹ This province was one of the poorest of the provinces of Palestine and contained the districts of Beersheeba and Gaza. Agricultural production, mainly the production of wheat and barley, provided this province with its main economic base. Most of the industrial production centers and port and communications facilities of Palestine were concentrated in the central coastal plain and northern regions of the country. These centers became part of the Israeli state which led to the expulsion of most of their indigenous populations to the areas of what came to be termed the Gaza Strip and the West Bank.

The extraction of the Gaza Strip from the rest of the country and the emigration of a large segment of the population of the greater province and other northern Provinces to it in 1948, left the Gaza Strip with basic burdens that have plagued its existence until today. In 1948, a population of approximately 190,000 emigrated to this artificial entity from the Gaza and other northern provinces of Palestine to bring its total population to approximately 280,000.¹⁰ The displacement of that large population and the dismemberment of the Gaza Strip from the Gaza Province, resulted in an overall disruption of economic activities and the permanent separation between the inhabitants and their original sources of livelihood and to the severance of all economic ties between this new entity and the rest of Palestine.

The two remaining territories came under the control of different states and were disconnected from each other during the period of 1948 to 1967. During that period, each territory had to redirect its economic and social links and establish new ones with the states of their new administrations. The Gaza Strip was placed under Egyptian rule while Jordan took over the administration of the West Bank. A comprehensive process of economic, social and political integration occurred gradually between the West Bank and the Kingdom of Jordan,

⁹ Ziad Abu-Amr, "The Gaza Economy: 1948 - 1984," in George Abed, ed., *The Palestinian Economy: Studies in Development Under Prolonged Occupation* (London, 1988) 101(Abed p101)

¹⁰ Ibid

while the Gaza Strip was administered as a separate entity distinct from the governing state until it was occupied by Israel in 1967.

As a result of its limited resources, inability to support independent economic development, and its physical separation from Egypt proper, the Gaza Strip functioned as a place of permanent residence for an increasingly mobile segment of its population which gained access to direct employment in the surrounding Arab region.¹¹ The easy access of the local inhabitants to Egyptian institutions of higher education provided an increasing segment of the local population with academic and professional qualifications that enhanced their access to jobs in the growing economies of the Arab Gulf states. The remittances from these workers to their families in the Strip became an important source of funding for the local economy.

The population of the Gaza Strip increased steadily during the 1950's at the rate of 2.7% and reached 373,292 in 1960. On the eve of the occupation in 1967 the population had climbed to 455,000 but declined to 354,000 in 1968 due to direct expulsion, emigration or the rejection by the Israeli authorities of the return of residents who were outside the Strip when Israel occupied the territory.¹² The population began to increase again in the 1970's and reached 510,000 in 1985 with a density of 1,400 persons per square kilometer.¹³

During the period of Egyptian administration, the agricultural sector was the main local contributor to the local economy of the Strip. It comprised 70% of the GDP, and employed 30% of the local labor force. It also represented 90% of all exports.¹⁴ The industrial sector, however, remained very confined. Its contribution to the GDP by the end of the Egyptian period was only 4.2%. It employed 3,000-6,000 workers which dropped to 2,700 at the initial phases of the Israeli occupation in 1967.¹⁵ By the end of the Egyptian administration period the number of manufacturing firms in the Gaza Strip had reached 1,000. The majority of these firms (92%) employed less than 10 workers.¹⁶ Only fourteen large scale firms existed in the Gaza Strip during that period, involved in processing of agricultural products, beverages, rug and textile weaving activities. Most local products were marketed locally, except for a small

¹¹ Gharaibeh, *The Economies*, 17.

¹² Abu-Amr, "Gaza Economy," 101.

¹³ Sara Roy, *The Gaza Strip Survey* (Boulder, Colorado, 1986), 5.

¹⁴ Abu-Amr "The Gaza Economy," 105.

¹⁵ Ibid, 109.

¹⁶ Bakir Abu Kishk, "Industrial Development and Policies in the West Bank and Gaza" in George Abed, ed., *The Palestinian Economy*, 168.

percentage of the goods produced by the larger firms that were exported to or through Egypt.¹⁷

The designation by Egypt of the Strip as a Free Trading Zone in the 1960's brought some prosperity to this area and enhanced trade activities, but adversely affected the development of the local industrial sector through an increased competition with imported goods. This change in status resulted in a drastic increase in imports to the Strip, not solely for the consumption of its residents. Most of these imports were aimed at the influx of Egyptian shoppers who made frequent visits to the Strip for acquiring imported goods that were restricted in the Egyptian market. The Gaza Strip also benefited from the presence of the UN peace keeping force which relied on services provided by the population and introduced hard currency into the local economy.

2.2 OUTCOME OF OCCUPATION:

The Israeli military occupation of the West Bank and the Gaza Strip not only represented a violation of the territorial and the human rights of the Palestinian population, it also initiated a comprehensive process of restructuring of the economies of the two territories, making them subservient to the requirements of the occupying state. Manufacturing firms in the occupied West Bank and the Gaza Strip have evolved under a restrictive militarily imposed policy which is based on the interests of the occupying state and aimed at safeguarding Israeli producers and their access to the captive markets of the territories. The interests of local Palestinian firms, large or small, formal or informal were not taken into account and were comprehensively obstructed unless these firms provided direct services for Israeli firms or productive sectors. These services usually took the form of subcontracting or other production activities that capitalize on the cheap local labor force for the benefit of the Israeli economy in general.

Palestinian firms were left with two basic options for conducting their production activities: the first was to function within the framework of regulations and thus avoid confrontation; the second was to function within the highly restricted informal sector. Three categories of firms evolved during the initial phases of occupation, each with a different response to the restrictive conditions introduced by the occupying state:

1 - Some local firms decided to enter lines of production in direct association with Israeli firms

¹⁷ Roy, *Survey*, 55.

through subcontracting relations.¹⁸ These firms functioned under the protective umbrella provided by the Israeli firms and confronted few limitations in maintaining a formal status and conducting their transactions within the framework of regulations put in place by the occupation authorities. The relatively large size of demand and the stable relationship provided by the parent firms enabled the local subcontractors to adopt specialized assembly-line production processes which were characterized by relatively large, fixed capital investments in modern machinery, performing specialized tasks.

2- Other firms went into production activities that were formally less restricted by the Israeli authorities during the initial years of occupation. Firms in this category usually manufactured goods that were not in direct competition with Israeli firms, or provided Israeli firms with production services that capitalized on the low-cost labor in the territories. Unlike subcontracting firms, the transactions of these firms were independent of Israeli firms and thus did not gain their direct protection. However, they maintained a formal status and functioned within the regulatory framework implemented by the occupation authorities and in doing so were able to reduce their confrontations with them. They faced limited difficulties in establishing links with Israeli formal sources of raw material, machinery and technology transfer. These types of firms had the option, depending on their financial capabilities and the size of their target market, of starting out as small or large-scale specialized production activities, producing specific products for niches in local or Israeli markets. Most of these firms evolved as rigid production operations and were relatively secure with placing large initial fixed-capital investments because of the availability of a stable niche in local or Israeli markets and limited confrontations with the occupation authorities.¹⁹

3 - Other firms decided to gradually enter lines of production that are in direct competition with Israeli producers and thus in direct conflict with the restrictions of the occupation authorities. These types of firms were only able to begin their activities as small-scale flexible production or maintenance operations. Most of these firms maintained the flexibility of their production processes even if they were able to secure a stable market niche because of the intense competition with local and Israeli firms and the unpredictable shifts in Israeli policy. These

¹⁸ Many of these relationships were established immediately after the occupation of the territories by Israel. In most initial cases, Israeli firms initiated these relationships.

¹⁹ These production activities became increasingly restricted during the later years of the occupation and began facing various restrictions by the departments of the Israeli authorities and Israeli competing firms.

types of firms were only able to function outside the regulatory framework implemented by the occupying authorities and thus maintained an informal and unregistered status throughout their initial years.²⁰ These firms were able to grow based on their informal access to niches in local and Israeli markets as well as their links with formal and informal Israeli suppliers of raw materials, machinery and technology transfer.

As a result of a series of shifts in Israeli policy toward the territories during the later years of occupation, as well as the development of increased competitiveness between firms within the two latter categories that began presenting Israeli firms with a viable source of competition, the conditions facing local firm activity began to change. The Israeli authorities gradually increased the limitations of their regulatory framework for firms involved in previously unrestricted areas of production, making it increasingly difficult for such firms to function. Some of these firms were forced to transform a segment of their activities from the formal to the informal realm in order to bypass some of the restrictions and avoid the risk of using over-exposed and thus vulnerable links. The authorities also expanded their surveillance of activities of informal firms, forcing most of them to formalize part or all of their activities or remain confined to a limited local economy with no reliable access to Israeli formal or informal sources of raw materials and machinery or market niches.

2.3 PHASES OF OCCUPATION:

In this section, I will briefly identify the phases of the occupation period that were shaped by shifts in Israeli policy and their impact on the pattern of manufacturing firm development in the territories. These phases are based on the experiences of the firms within the sample and are reflective of the shifts they witnessed in dealing with the Israeli authorities, Israeli economic sectors and shifts in the local economic and political conditions.

The First Phase (1967-1969): The Initial Years of Occupation.

The occupation of the two territories by Israel in 1967 resulted in the disruption of most formal links between the territories and the economies of Jordan, in the case of the West Bank,

²⁰ Many of these firms were forced to formalize their activities after the intensification of surveillance of local informal economic activities at a later stage.

and Egypt, in the case of the Gaza Strip.²¹ While some informal links between the West Bank and Jordan were maintained, they had to occur under the supervision of the Israeli authorities. All formal and informal links between Gaza and Egypt were disrupted and were replaced by new informal links with the West Bank and through it with Jordan.

This phase witnessed the dramatic growth in one-sided trade activities between the newly occupied territories and the occupying state.²² This led to the unrestricted and unchallenged influx of Israeli goods into the markets of the territories and the paralysis of the remaining production activities in both territories. This phase also witnessed the gradual absorption of the local labor force into sectors of the Israeli economy and the establishment of subcontracting relations between Israeli parent firms and local production shops capitalizing on the cheap labor force.²³

The Second Phase (1970-1973):

The start of this phase brought with it the relative end of the active resistance to the Israeli occupation that developed during the initial phase.²⁴ During this phase, the concept of the permanency of the Israeli occupation began to sink in.²⁵ The local population began to realize that it would be a long term affair and would not end after a period of six months, as the earlier 1956 Israeli occupation had. The population seemed to be leaning towards surviving through this occupation.

During this phase, the subcontracting relations between Israeli firms and local producers were further developed and additional numbers of local workers were absorbed by the Israeli economy, attracted by better pay and a lack of local employment opportunities. Production activities that could pose a potential for competing with Israeli producers in the local or Israeli markets were formally restricted by the Israeli military authorities. During this phase

²¹ All Arab and international commercial and development banks, as well as development agencies, were closed and branches of Israeli banks were introduced to replace them.

²² The value of Israeli goods sold in the territories have reached \$368 million in 1975, which amounts to 19% of the total Israeli exports for that year, ranking higher than its exports to the United States. Awartani, *A Survey of Industries*, 45.

²³ The number of Palestinian workers employed in Israel has climbed from less than 5,000 in 1968 to more than 20,000 workers by 1970. Gharaibeh, *The Economies*, 49.

²⁴ The initial phase witnessed open resistance to Israeli occupation represented by military action by Palestinian commandos within the territories and disobedience by the population.

²⁵ This period was characterized by a general feeling of depression after the brutal crushing of Palestinian resistance in the late 1960s. (Geoffrey Aronson, *Israel, Palestine and the Intifada, Creating Facts on the West Bank* [London / Washington, 1990] 46).

however, local entrepreneurs began venturing into the establishment of production activities that targeted the limited niches of local and Israeli markets. Firms that had survived the transitional first phase began consolidating their production activities, establishing new local market niches and creating new links with the Israeli economy or through it with external sources of raw materials, machinery and technology transfer. These firms capitalized on the knowledge that they had gained through their trade relationships with Israeli firms and retailers which they used to enhance their understanding of the Israeli and the emerging local market. The contact between the Palestinian workers with the Israeli firms and their increased acquaintance with Israeli markets, producers, and suppliers of raw materials also contributed to the appearance of local firms in various production areas.

The Third Phase (1974-1982):

After the 1973 war between Israel and the Arab states, the population of the territories began to more openly challenge the established status quo.²⁶ Local producers began to more aggressively challenge Israeli firms in local markets as well as in the Israeli market. The Israeli military authorities responded to this shift in attitude with a shift in its policy and the intensification of its implementation techniques. Local firms began facing obstacles at all levels of their operations. Direct access to import facilities for local firms became plagued with prohibitive restrictions. The flow of local products through the border crossings became more aggressively monitored. Taxation rates and tax collection techniques were intensified and additional taxes were introduced.²⁷

Land and water resource confiscation by the military authorities with the support of various Israeli civil departments escalated. The radical increase in the establishment of Israeli settlements within the territories increased the pressure on the local population and further disadvantaged local production firms by absorbing more local labor and competing more effectively with local firms because of tax breaks and other incentives that they enjoyed from the Israeli government. Israeli firms within the territories began receiving a wide range of

²⁶ The 1973 war between the Arab states and Israel revived the hope of the local residents that the end of the occupation could be near. It also became obvious to the Israeli authorities that the links between the local populations and the Palestinian resistance movements have not been terminated, but were alive and well. This phase was characterized as a period of a "renewal of faith" by Aronson. (*Intifada* , 50).

²⁷ The governmental components of the regulatory framework began to tighten their grip over economic activities in both territories and between the territories and Israel.

incentives such as tax breaks, low-cost services, affordable loans and functioned under a totally different set of protective laws, that are not applicable to local firms.²⁸

The Fourth Phase (1983-1987):

The Israeli military government established the department of civil administration with the purpose of legalizing all the emergency military laws and amendments to laws implemented by the military government during the previous years.²⁹ The goal was the “normalization” of the occupation, transforming these temporary military laws to permanent ones. The military, however, maintained full control over the newly established department and continued issuing new laws and amending others in areas that fell under the jurisdiction of the civil administration. The ability of the Israeli civil ministries that had representatives within the new department to influence its course of action was very limited. Even the Israeli Supreme court could not change or challenge decisions made by the military government.³⁰

The system of policy implementation and the surveillance of local economic activities was further intensified. Palestinian bureaucrats were hired by the new civil administration department, but their positions were inferior to Israeli officials. Israelis were assigned critical positions at all levels to reduce the ability of the Palestinian bureaucrats to introduce inconsistencies in the implementation of Israeli policy.

Local firms continued to face increasing restrictive measures, increased taxation rates and intensified collection and harassment methods at all levels of their activities. The surveillance of economic activities and the apparatus of policy implementation was further enhanced. The taxation and customs departments created an effective system of communications through which each department could gain information about the activities of local producers. The border crossing points and the periodic raids on production plants were increasingly used to force the formalization of all local firms with links to the local or Israeli

²⁸ “Israeli companies registered in the territories, with both management and ownership in the hands of Israelis, pay no local taxes and thus use the territories as tax shelter”. (United Nations Conference on Trade and Development, “The Palestinian Financial Sector Under Israeli Occupation,” [New York, 1989], 93).

²⁹ The introduction of the Civil Administration department represents a public relations stunt by the Israeli authorities to curb the criticism by the other Camp David partners who were pushing for the idea of autonomy for the Palestinian inhabitants. As Foreign Minister Shamir explained in 1981: “Autonomy does not mean sovereignty, and autonomy... does not mean a Palestinian state. And we came forward with this proposal not so that it (autonomy) will become a stage in our road toward detachment from Judea, Samaria, and Gaza. On the contrary, we suggested autonomy in order to remain in those areas.” (Aronson, *Intifada* , 253).

³⁰ Roy, *Survey*, 127.

economy.

Israeli firms in competition with local producers were encouraged and supported to contribute to this system of control over their local counterparts. They began to function as informants on the activities of local producers in Israeli and in some cases, in local markets. They did not hesitate to use their contacts within the Israeli government departments to shut down local competitors through increased harassment, intimidation, and taxation raids. They were also able to disrupt links between local producers and their Israeli sources of raw materials, machinery and technology transfer.

It became obvious where these conditions were leading. The Israeli military authorities assumed that all this pressure would somehow be absorbed by the local inhabitants and the result would be a more obedient, cooperative population. That did not occur.

The Fifth Phase: The Palestinian Uprising (1987- Present).

The advent of the Palestinian uprising in 1987 marked another episode of rejection of the status quo by the local population and the attempts by the authorities to normalize the impact of restrictive policies on the local population. The uprising triggered a series of radical changes to the above discussed conditions, resulting in what seems to be a permanent disruption of links between the two economies. Both economies have been adversely affected by this disruption, but the most damage was experienced by the more dependent Palestinian economy.³¹ In addition to the disruption of economic links between the two, additional punitive economic measures were introduced coupled with more intensive surveillance and policy implementation techniques. Excessive taxation rates and a wide range of collection procedures were introduced. Palestinian income earners, laborers, producers, professionals and retailers were forced to formalize their status if they were to gain border access to Israel or the West Bank or maintain a local retail or production activity. This was done through the issuance of computer cards revealing each individual's personal tax records, utility payment and security records at all border check points of the territories.³² This meant that each individual is subject to an on-the-spot haphazard taxation payment claim by the tax officer in charge at a given check

³¹ Israel experienced a 35% decline in its trade to the territories while personal income declined 75% by 1989 from its 1987 level. Roy, "The Political Economy of Despair," 61.

³² These ID cards were introduced along side the regular ID card that is held by all inhabitants of the territories age 16 and over. This new card is valid for six months and to renew it, each holder must present clearance forms for all taxation dues and utility payments.

point. Taxation and product confiscation raids on local producers and retailers are systematically carried out by taxation officials supported by army units even when monthly tax payments have been made by targeted individuals. Previously approved monthly tax estimates by the taxation authorities are often subject to cancellation at the discretion of a taxation officer, even if monthly payments have been made on schedule.³³

As an outcome of the Uprising and the boycott by Palestinian consumers of Israeli goods that could be produced locally, Israeli producers lost their relatively unchallenged access to the markets of the two territories. The access of Israeli producers to the cheap local labor force through subcontracting was reduced considerably, causing some Israeli firms to shut down or find other alternatives. Palestinian producers who relied on subcontracting relations with Israeli firms or on informal access to Israeli markets lost most of these links and were forced to alter their product to meet local demand. The boycott of Israeli products by local consumers, on the other hand, created a considerable opportunity for some local producers to fill gaps and expand their production. These new conditions had a positive impact on some subsectors and on firms that were capable of substantially altering their production to suit local demand. But the relatively small size of local markets and the restriction of mobility between the two territories, as well as a 75% decline in per capita income of the local population during the years of the uprising set rigid limits on the extent to which subsectors could grow.³⁴ The total reliance of Palestinian producers on Israeli sources of raw materials, machinery (new and used) did not change, although the deterioration in relations between the two communities, as well as increased border crossing and communication difficulties for Palestinian producers, increased the vulnerability of these links.

Israeli bank services were reduced further and the number of bank facilities was cut considerably while the remaining ones were relocated from central city and town locations to designated border zones. The Palestinian migrant labor force continued to seek employment in Israel but the numbers have been declining as a result of border crossing difficulties, increased racial attacks and a systematic reduction and replacement of this labor force by Israeli laborers being pushed down the economic ladder due to the influx of new Soviet immigrants.³⁵

³³ See section 4.3 for more detail on intensification of regulations and practices during the uprising.

³⁴ Roy, "The Political Economy of Despair," 61.

³⁵ The number of Palestinian workers employed in Israel declined from 120,000 by 1987 (45% of the total local labor force) to 10,000 in 1990.

2.4 THE AREAS OF CONTROL:

During the last 22 years of Israeli occupation, the economic growth of the West Bank and Gaza Strip in general, and the development of the industrial sector in particular, have been obstructed through a tailored system of constraints put in place by the occupying authorities in the areas of finance, markets, labor, technology transfer, raw materials, institutions, infrastructure and access to land and water resources. This system gradually transformed the local economy, including all its productive sectors, into a captive economy, subservient to that of the occupying state.

With the Palestinian uprising an attempt is being made by the population of the territories to reduce the dependence of the local economy on that of Israel, as well as to develop a sub-system through which alternative economic channels and linkages can be developed to facilitate the gradual disengagement of the two economies. This attempt at disengagement is being done at a considerable cost to both economies through a series of coordinated local popular actions, resulting in structural changes and a redirection of the economy and its various sectors.

The contribution of the industrial sector to the GDP of the territories decreased from 8.3% in 1968 to 6.9% in 1983, maintaining its position as the smallest contributor to the local economy.³⁶ By 1983, the industrial sector employed 17,000 (15%) of the domestic labor force reflecting a low level of labor productivity. In 1985, 6,650 (40%) of the domestic labor force was self-employed, while the remaining 60% were employees. The total number of firms in both territories was 4,255 in 1985; 1120 (25%) were one-person enterprises; 3,800 (90%) employed less than 9 workers and 265 (8%) enterprises employed 9 workers or more.³⁷

³⁶ Antoine Mansour, "The West Bank Economy: 1948 - 1984," in George Abed, ed., *The Palestinian Economy* (London, 1988), 85.

³⁷ Sadler, "Overview of the Investment Opportunities," UNIDO, 5.

Table 1 Distribution of establishments in the West Bank & Gaza Strip by major branch in 1985 to 1987.

Major Branch	Total number of establishments		% of establishments	Total employed	Thereof employed	% of total employed		Average employed /establishment	
						Gaza	West B	Gaza	West B
Food, Beverages & Tobacco	1985	340	8.2	1,932	1,324	6.5	14.3	3.7	6.6
	1987	365	8.8	2,439	1,789	7.1	16.0	4.5	7.7
Textiles and clothing	1985	1000	24.2	4,923	3,371	40.7	22.3	4.7	5.1
	1987	1080	26.1	6,098	4,417	42.9	24.8	5.3	6.2
Leather and its products	1985	220	5.3	878	488	-----	8.2	-----	4.0
	1987	199	4.8	971	574	-----	8.1	-----	4.9
Wood and its production	1985	863	20.9	2,332	975	16.7	12.1	3.0	2.5
	1987	843	20.9	2,324	1,012	15.6	9.9	2.2	2.4
Rubber, plastics & chemicals	1985	64	1.5	976	871	-----	9.1	-----	15.3
	1987	68	1.5	1,254	1,157	-----	10.5	-----	18.4
Nonmetallic materials	1985	400	9.7	1,908	1,141	12.0	9.4	3.4	5.3
	1987	489	11.8	2,164	1,328	14.0	9.6	3.6	5.5
Basic metal & metal products	1985	972	23.5	3,038	1,518	18.3	17.8	3.3	3.0
	1987	1018	24.7	3,068	1,531	17.4	15.0	3.2	2.9
Other industrial products	1985	475	11.5	1,820	1,066	17.8	6.6	3.8	4.0
	1987	479	11.5	1,970	1,236	16.9	6.1	3.8	4.8
TOTAL	1985	4,126	100.0	16,905	10,252	100.0	100.0	3.8	4.3
	1987	4,255	100.0	19,270	12,453	100.0	100.0	4.0	4.9

Source: Peter Sadler, "Overview of the Investment Opportunities," UNIDO (Vienna, 1989) 5.

This chart combines the information which was provided by two separate charts for the West Bank and Gaza Strip.

The concentration of manufacturing activities in small-scale workshop type enterprises, and the overall stagnation or decline in the growth of the manufacturing sector, has to be viewed against the relationship of the occupied territories to Israel. Policies in the areas of finance, access to markets, technology transfer and labor, had the most direct impact on shaping the pattern of development of this sector.

Finance:

In 1967, the Israeli authorities issued an order closing all functioning Arab and non-Arab financial institutions in the West Bank and the Gaza Strip, including commercial,

industrial development banks and agricultural credit corporations. Branches of Israeli commercial banks were established, usually with one branch per town or village. Israeli currency (IS) was declared legal tender in both territories. However, the Jordanian dinar (JD) was allowed to be used by the population of the West Bank only but not the Gaza Strip. The Egyptian currency was declared illegal in the Gaza Strip. The conversion of the Jordanian dinar was done at rates established through the involvement of the IMF and adjusted in accordance with the international value of the two currencies.³⁸ The continuous decline in the value of the IS led the inhabitants of the occupied territories to use it as only a medium of exchange and dealing with Israeli individuals or firms, or for other short-term transactions. The JD & US \$ were used for long-term transactions, investments, rent, land purchase, and wages (wages of Palestinian workers in Israel are in IS).³⁹

BANKS:

Since 1967, the Israeli military authorities have been entrusted, via an "Examiner of Banks", with powers over banking and monetary operations. His role included the licensing of banks and foreign exchange dealings, administering bank assets and liabilities, closing and/or liquidating banks, establishing the level of credit, interest rates, liquidity and determining a wide range of other banking and monetary regulations. Branches of Palestinian banks allowed to reopen in the 1980's (only one branch was allowed to function in each territory) were also placed under the powers of the "Examiner of Banks", denying them any level of independence.⁴⁰

Israeli Banks:

As a result of restrictions by the military authorities and as the outcome of the overall Israeli policy towards the territories, Israeli banks have not functioned as effective financial intermediaries within the territories by accepting deposits and extending credit. They have only offered short-term credit (max. 10 months at 25-30% interest), which is not suitable for funding industrial and agricultural sector projects. The total credit extended by Israeli banks averaged 10% of all their deposits by the local inhabitants and only 8% of their total assets

³⁸ UNCTAD, "The Palestinian Financial Sector," 36.

³⁹ Ibid.

⁴⁰ Ibid.

(1.27% of the territories GDP). This reflects that a large percentage of funds deposited by local customers are siphoned out of the territories to be deposited with central Israeli banks for use in the Israeli economy.⁴¹

The loans extended by these branches were short term, for up to one year, suitable for commercial purposes and partly as operating capital for agriculture or industry. No long or medium-term credit facilities that could effectively benefit the industrial sector were offered by any of those branches. Based on a random sample survey of 716 industrial enterprises in the occupied territories, none resorted to Israeli bank funding.⁴² The interest rate on loans was in the range of 25-30% and on overdrafts was 39-50%. In 1986, another fee of 8% on total amount was also charged. Security was required in the form of mortgage funds, and had to be deposited in the client's account.

These banks have therefore been used by the inhabitants for short term transactions. The total amount of deposits in 1984 has reached only 7.5% of national income of the territories, compared to 29% in 1966. In 1984, due to the continuous decline in the value of the I.S vis-a-vis the JD or \$ U.S, 80% of those deposits were in JDs or other foreign currency compared to only 12% in 1977.⁴³

ARAB FINANCIAL INSTITUTIONS:

Palestinian banks have not been able to fill the gap as a result of the restrictive policies and close level of surveillance by the authorities, but have been administering the allocation of limited funds from external sources for use in production projects.

The Bank of Palestine: (Gaza)

This bank was established in Gaza in 1960 during the Egyptian administration period, but was closed in 1967. In 1981, it was allowed to reopen, "but was placed under the full supervision and control of the bank of Israel through the "Examiner of Banks," as is the case with all local branches of Israeli banks".⁴⁴ The bank also became liable to scrutiny under the strict control of the local military administration. The bank was allowed to extend basic banking

⁴¹ UNCTAD. "The Palestinian Financial Sector," 42.

⁴² Tuma & Hazboun. "Industrialization in the Territories," 6.

⁴³ UNCTAD. "The Palestinian Financial Sector," 43.

⁴⁴ Ibid., 51.

services but was not allowed to reopen its other branches in other cities of the Gaza Strip. The bank has been allowed to maintain its Egyptian pound (LE) account, but all transactions have to be done in I.S. resulting in indexing all customer loan repayments to \$ U.S to compensate for the devaluation of the Israeli currency. It has not been allowed to act as an authorized dealer in foreign currency, which excludes it from facilitating trade transactions with Jordan and the rest of the world. This bank pays an income tax rate of 37.5%.⁴⁵

In 1984, the assets of the Bank of Palestine were LE 4.68 million, of which LE1.7 million were in loans and discounted bills, LE 2.25 million in cash, and LE 1.25 million in equity capital, of which LE 0.5 million in share capital. The value of total deposits and client accounts was LE 3.23 million. The rate of credit averaged 30% of total deposits, resulting in high liquidity ratio compared to the recommended commercial banking standards of 70%.⁴⁶ Attempts to increase its limited capital by three fold in 1986 were obstructed by the Bank of Israel.

Loans offered by this bank are of a 10 month maximum period, at 13% interest. The signatures of four persons are required as a guaranty. This bank has been playing the part of a financial intermediary in channeling and administrating loans for agriculture and industry. In coordination with the Union of Citrus Growers a loan of \$100/ Dunum was channeled to owners of groves of 10 dunums or more, at 13% interest. In 1984 the bank reached an agreement with a U.S. P.V.O, The Community Development Foundation (CDF), which enabled it to channel and administer a loan of \$ 0.5 million, earmarked for individual borrowers. It has also financed the purchase of 48 Italian tractors through a loan advanced by an Italian PVO.⁴⁷

Money Changers:

Money changers existed during the period of Jordanian control of the West Bank and were allowed to function by the Israeli authorities legally in the West Bank but not in Gaza. Those private enterprises flourished to a great extent in both areas due to the absence of national banking institutions.

Their success was enhanced by a number of factors:

⁴⁵ UNCTAD, "The Palestinian Financial Sector," 55.

⁴⁶ Ibid., 52.

⁴⁷ Ibid., 54.

- The recognition by the Israeli authorities of two currencies as legal tender (JD & IS), which made money changing a daily affair, intensified by continued depreciation of the IS.
- Arab financial support, employee payments from Jordan, and remittances, which are largely transferred to the territories through money changers.
- No direct banking channels between the territories and the Arab world.
- Flexibility and speed, and exchange rates closer to the regional & international market than those of local Israeli banks.⁴⁸

The functions performed by money changers vary from the basic exchange of currencies, to the investment on behalf of clients in stocks, shares, firms and other investments in the Arab world or abroad in addition to extending loans and accepting deposits. Their role as financial intermediates remains limited in scope, catering to small-scale, short-term financial ventures. Their contribution to the industrial sector remains insignificant.

Israeli government funding for the productive sectors has been negligible. In 1986 for example, the agricultural and industrial sectors received 1.6% (\$1.7 million) and 0.6% (\$620,000) of total government expenditure in the two territories, while 35% (\$37 million) and 20% (\$20 million) were allocated to education and health.⁴⁹

The most significant source of finance has been external, represented in factor income transferred to the territories in the form of remittances from Palestinian workers in Israel or abroad, as well as funds from external governmental and non-governmental sources. The contribution of factor incomes to the economy of the occupied territories in 1984 was 30% of their GNP and 43% of GDP. In 1987 the number of Palestinians employed in Israel reached 120,000, of whom 90,000 were formally accounted for. The rest were unregistered, fluctuating in number between 30,000-55,000 during the period of summer and agricultural harvest seasons, when school children on their summer breaks and women are usually recruited. In 1984, the net official factor income transfers through employment in Israel, after deducting 40% for income tax & social security, was \$189 million.⁵⁰

In 1984, 16,000 residents from the occupied territories were employed abroad. Remittances from this source was \$107 million. These funds were brought back to the territories by the workers during their visits, or were transferred through money changers. In

⁴⁸ UNCTAD, "The Palestinian Financial Sector," 63.

⁴⁹ Ibid., 76.

⁵⁰ Ibid., 104.

1984, remittances from migrant Palestinians to the areas reached \$257 million, mainly transferred through money changers or relatives.⁵¹

Marketing:

The unlimited freedom of access of Israeli goods to the markets of the territories and the total formal restriction of access of Palestinian goods to Israeli markets (access is permitted by the Israeli Ministry of Trade and Industry for specific products), coupled with limited access to export markets, severely confined marketing options for Palestinian producers. By 1987, only 10% of the total production of the occupied areas (in agriculture and industry) was exported. Out of total exports, 78.8% (\$303.7 million) went to Israel, representing a drastic shift in trade destination compared to 1969 when Israel was receiving only 40% while the remaining 60% went to Jordan or through it to other markets. Imports from Israel were 91.4% (\$961.2 million) of all imports (\$1,051.2 million) in 1987.⁵²

In addition to restrictions on trade implemented by the occupying power, Arab states including Jordan require a "Certificate of Origin" with every product imported into their markets from the two territories. This certificate is needed to verify the origin of all inputs and raw materials used in the production of the the exported good, resulting in the rejection of goods utilizing raw materials originating from Israeli producers or imported through Israeli ports (this policy is the result of the overall Arab League boycott of Israeli goods). The high custom rates applied on raw materials if imported through the bridge and the high transportation costs for shipping acquired raw materials through this route, prevent local producers from purchasing their raw materials from or through Arab sources.

Raw Materials:

The Israeli authorities have restricted the import of most inputs required for local production from or through Jordan, and have levied a very high custom payment on the limited amount of goods permitted to be imported through this route, resulting in drastically elevated costs for local producers. These restrictions on the import of inputs from or through non-Israeli sources have rendered most attempts at establishing significant trade links with or through the Arab states impossible. These limitations give Israel a total monopoly over trade with the two

⁵¹ More details about pattern of fund allocation by local and international organizations will be discussed in the institutions section of this chapter.

⁵² Sadler, "Overview of Investment Opportunities," 4.

territories.

Examples of goods not permitted access through this route are: all inputs required by the local textile industry, sheet metal required for the basic metal industry exceeding 3 mm in thickness as well as inputs for the pharmaceutical and chemicals industries.⁵³ All such goods could only be obtained through Israeli producers or import agents. The direct import of raw materials, machinery and other goods by local Palestinian producers through Israeli ports has also proven to be plagued with difficulties. In addition to the problems faced by Palestinian importers in obtaining import licenses as a result of a series of prohibitive bureaucratic procedures, all goods imported by Palestinian importers are subject to an extensive and in most cases destructive security check at the port facilities. This procedure entails the dismantling of all imported components and their impoundment in bonded facilities for unspecified periods. Furthermore, local importers are burdened with the total cost of conducting these procedures as well as storage fees for goods awaiting these checks.⁵⁴

As a result of such difficulties, Palestinian producers and importers have resorted to Israeli import agents and middlemen who are not subject to the above described security procedures for the import of all their required goods. This has left these agents with a considerable measure of control over the price, rate of flow, quantity, as well as quality of inputs required by local manufacturing firms, leaving local firms with no alternative or independent access to inputs. Direct links between local producers and external sources of raw materials and machinery have thus been critically limited resulting in the gradual deterioration of an independent access to sources of technical assistance and technological innovation. As a result of the increased difficulties for local importers, goods that are imported from external sources have declined to less than 10% of the total imports of the two territories. Eight percent are acquired through Jordan while the remaining 82% has to be purchased from Israeli producers.⁵⁵

With the increased port restrictions and the high custom and taxation rates on imported goods by the Israeli authorities, Palestinian producers became increasingly dependent on Israeli sources of used and in most cases technically out-dated production equipment and machinery.

⁵³ Rose Mesleh, "Industry in the West Bank 1967-1979: The Situation of Institutions, Labor and Wages," *Shuun Filastin*. (February, 1980) (Arabic) 24.

⁵⁴ For more detail, see chapter five, section 5.2.

⁵⁵ Mesleh, "Industry in West Bank," 25.

Israeli firms intending to up-grade their productive capacity have been guaranteed an outlet for their outdated and defective production equipment in the markets of the two territories, supplying local producers with up to 80% of their needed equipment. It is true that access to this source of low-priced machinery was helpful for some local producers, but the confinement of most local producers to such machinery has limited their ability to compete with Israeli modern sector producers. This phenomenon further reduced the access of local producers to technical assistance and a possible channel for technology transfer. Almost none of the Israeli firms selling equipment are willing to provide any technical assistance or training on the machinery they sell, while the original Israeli importers or producers of this machinery could no longer provide any such service to the new owners due to the expiration of their service plans.

Labor:

The overall stagnation in the Palestinian economy and the restricted growth of its various sectors resulted in the increase in the rate of unemployment in the territories. This gradual growth in surplus labor was systematically absorbed by specific segments of the sectors of the Israeli economy in the form of migrant daily laborers. In 1970 the number of officially registered labor force in Israel was 20,000, 12% of the domestic labor force of the two territories. By 1973 this number increased to 61,300 (31.5%) and reached 90,000 (36.5%) in 1985. Unofficial estimates which include undocumented workers have indicated that on the eve of the uprising, the number reached 125,000 (42%).⁵⁶

This process resulted in the transfer of the skilled and semi-skilled labor force, including a high percentage of high school and university degree holders unable to gain access to employment locally and unable to seek employment elsewhere due to travel restrictions. A large segment of the highly skilled labor force, as well as university degree holders capable of traveling, have left the territories for employment in the neighboring Arab states. Palestinian workers employed in Israel are confined to specific sectors in the Israeli economy, primarily construction (47%), low-tech industry (20%), agriculture (13%), services and other sectors (20%).⁵⁷

⁵⁶ Mohammed Shadid, "Israeli Policy Towards Economic Development in the West Bank and Gaza," in George Abed, ed., *The Palestinian Economy* (London, 1988), 126.

⁵⁷ United Nations Industrial Development Organization, "Survey of the Manufacturing Industry in the West Bank and Gaza Strip," (1984) 57.

Institutions:

The inability of local as well as international funding organizations to bypass the system of controls set up by the occupying power resulted in the allocation of most of their funds to projects or sectors relatively less restricted by the occupier. During the period 1979-1985, only 4.4% (\$18 million) of all funds provided by the Jordanian Palestinian Joint Committee went to the industrial sector, 8% (\$32 million) went to agriculture, while 25% (\$104 million), 16% (\$65 million) and 16% (\$65 million) were allocated to education, municipal and social/religious services respectively. During the same period, the United Nations Relief and Works Agency (UNRWA), allocated 19% (\$80 million), 55% (\$225 million) and 14% (\$56 million) to health, education and social/religious services respectively, while no funds were allocated to the industrial nor agricultural sectors.⁵⁸

In many respects, this pattern of sectoral allocation resembles the pattern of Israeli government expenditure in the occupied territories.⁵⁹ The similarity in the pattern of fund allocation presented above is an outcome of the Israeli system of control governing fund allocation decisions by local and foreign funding agencies. The funding of health, education and municipal services does not conflict with Israeli policies regarding development in the occupied territories. This is not to suggest that Israel is keen on improving the level of health, education and municipal services for the local population; this clearly is not the case considering the insufficient overall amount of funding allocated to these sectors, including funds from outside sources (UNRWA, JPJC). It is because Israel is obliged under international law as an occupying force to provide support in those sectors. The contributions by outside and local organizations to those sectors is in less direct conflict with Israeli policy and, in fact, relieves Israel of some of the burdens of its basic financial responsibilities.

The pattern of fund allocation by U.S PVOs as well as the United Nations Development Program (UNDP) reflect a slightly different character. During the period 1977-1983, 28% (\$10 million) of funds from U.S.PVOs went to agriculture, 34% (\$12 million) for water/sewage, while only 1.4% (\$0.5 million) to industry. Between 1980 and 1986, UNDP allocated 17% (\$1.5 million) to agriculture, 25% (\$2.2 million) to water/sewage, while only 1.1% (\$0.1

⁵⁸ UNCTAD, "The Palestinian Financial Sector," 124.

⁵⁹ See "Finance" in Chapter Two, Section 2.4.

million) was allocated to industry.⁶⁰ The selection of projects by U.S. PVOs is totally governed by Israeli requirements. Israel has been granted total control over the selection of local projects. The selection of projects by local or international donor agencies and local entrepreneurs is controlled by the process of permit issuance by the Israeli authorities.⁶¹

Most permits requested for the establishment of productive sector projects that could present a source of competition for Israeli producers or contribute to a process of healthy economic growth in the productive sectors of the occupied territories are denied. Delays in permit issuance through a series of lengthy bureaucratic procedures are common, and final acceptance is usually granted after all positive economic, social or political indicators reflecting the feasibility of the project at the time of application have changed for the worse. In many cases, applicants receive no response to their requests and eventually abandon their project proposals.

In the cases in which permits are issued, donors and local entrepreneurs face limitations and restrictions in other areas that lead to the collapse, stagnation or the limited growth of productive projects. At this stage, the main obstacles are met in developing access to local or export markets, access to raw materials, machinery, technology transfer and skilled labor.

THE LOCAL INSTITUTIONAL FRAMEWORK:

The pattern of evolution of local Palestinian non-governmental and private voluntary organizations was also shaped by an Israeli imposed system of controls. In order to remain functioning and avoid conflict with the Israeli authorities, most organizations adopted a low profile in aiding local development. Their contributions became limited to the provision of health, educational and social services and, in a few cases, if financially capable, aiding local municipal or village councils in meeting their service obligations to the local population necessary due to the continuous decline in Israeli government funding of local municipalities. Local non-governmental organizations and private voluntary organizations involved in fund allocation to the productive sectors, were confronted with endless obstacles resulting in the closure of a number of such organizations by the authorities or their abandonment of such projects. These conditions resulted in a decline in the level of experience and ability at the

⁶⁰ UNCTAD, "The Palestinian Financial Sector," 124.

⁶¹ Meron Benvenisti, *Projects Funded by the Government of the United States of America in the West Bank and Gaza Strip (1977-1983)* (Jerusalem, 1987) (Arabic) 14.

disposal of local organizations to effectively carry out a process of selecting, funding or administering a productive project.

Local organizations also suffered from a decline in the number of qualified personnel. A majority of the experienced and well-qualified personnel were attracted by more productive employment opportunities abroad or joined local universities. Links between local universities and local NGOs have not been allowed to develop as a result of the continuous closure of most of these institutions by the Israeli authorities, as well as the intentional disruption of any form of cooperation between universities and local organizations.

Political infighting and unproductive competition between Palestinian institutions has presented another barrier to constructive cooperation between local institutions. During the initial years of occupation the various political factions within Palestinian society used the fragile institutional framework to wage their wars against each other. Each local organization or group of organizations became affiliated with a specific political movement, resulting in the creation of rigid ideological barriers between the different organizations or groupings. Organizations became tools in the hands of political movements, which were usually based outside the territories. Gradually the activities of those organizations became unresponsive to the needs of their local target groups and were instead aimed at competing with other local organizations or engaging in unfruitful confrontations with the occupying power, resulting in the periodic closure of some by the authorities. Fund allocation through these politically motivated organizations was used to achieve political ends, usually remote from local needs. This phenomenon still exists to a certain extent, but has declined considerably after the advent of the uprising, which resulted in increased unity between the various political factions and their affiliated organizations.

Any attempt at the selection of a production project in the occupied territories must take into account the Palestinian Uprising and the movements which it has instigated in economy, social structure and institutional framework of the area. Proposals must have close regard for the movements which the uprising has generated and the attitudes which it has engendered. But with the continued dependence of most productive sector enterprises on Israeli producers or import agents for acquiring most of their needed inputs, and the total reliance on Israeli export/import facilities and restrictive bureaucratic procedures for acquiring project permits or gaining access to external and alternative markets, the vulnerability of projects in these sectors

remains extremely high.

The lack of indigenous institutions with protective links to international governmental and non-governmental organizations, set up for the purpose of channeling, allocating, administering credit and evaluating as well as facilitating secure access to markets, inputs and technology transfer to the productive sectors, represents another hurdle in the path of a coordinated process of economic development. The ability of local enterprises to achieve significant levels of growth could only become possible if such an institutional framework is strengthened or established. But in the meantime it is essential to explore limitations imposed by existing conditions for possibilities of growth, however limited, in order to maintain a feasible level of economic subsistence. There is some hope that limited growth may be achieved through targeting local demand and any possible access to alternative markets.

III STRUCTURE OF CONTROL:

3.1- Introduction.

3.2- Military and Civil Administration Apparatus.

3.3- Taxation.

3.4- Customs Duties.

3.1 INTRODUCTION:

The distinctive characteristic of the situation in the occupied West Bank and Gaza Strip that distinguishes it from other cases of authoritarian, colonial and even military rule, is the high level of consistency and the wide range of administrative levels at which the occupying power has been able to implement its restrictive policies. The two territories are ruled by a military government deriving its powers from the Israeli Ministry of Defense with legislative powers over all aspect of life in both territories. A Department of Civil Administration was established in the early 1980's with the role of making permanent all emergency, military laws passed or amended by the military government during the previous years. The military government, however, maintains full control over the activities of this department and has the power to pass new laws and amend others in areas under the civil administration's jurisdiction. All critical positions at both branches of government are controlled by military or ministry personnel, maintaining full supervision over all decision making processes and policy implementation. Palestinian officials are appointed by the Israeli heads of the departments and are confined to lower positions, functioning under extensive Israeli supervision.

Israeli policy towards the resources (land, water and other minerals) of the two territories has remained consistent since the initial stages of occupation. Through a series of large-scale physical interventions (such as the massive land and water resource confiscation in both territories), and extensive infrastructure projects (highway, power, water and communication grids), the Israeli state has been able to physically but not formally annex the two territories. The confiscated land (approximately 50% of the total area of the two territories) served to house a new Israeli settler population. Seventy percent of the renewable water resources of the West Bank and 90% of the Gaza Strip's were transferred to Israel proper. The new infrastructure linked the Israeli settlements with the state while mostly bypassing the existing Palestinian urban centers.

The Israeli policy towards the population of these territories originally resembled the policy towards the land and its resources, but has undergone a series of shifts during the years of occupation. Initially, the main goal of that policy was to achieve a total integration of the economies of the two territories with that of the occupying state while maintaining total dominance. Israel saw the two economies as providing a cheap labor force, subcontracting relations for Israeli firms (capitalizing on the locally employed labor force and low-cost

production processes), and most importantly, as a captive market for Israeli products. Ninety percent of all imports into the territories came from Israel in 1987, making the territories the second largest market for Israeli products after the United States.⁶² All economic links between the territories and the outside world became restricted and could only occur through the occupying state.

As this one-sided relationship evolved and was normalized by the Israeli authorities, it faced increasing resistance and challenge from the local population. Israel, in response to resistance from the local population, introduced an extensive enforcement apparatus which it dubbed the “Iron Fist Policy”.⁶³ This policy left no room for negotiations between the authorities and the local population. It translated into inflexible control over all aspects of life in the territories. Enforcement was highly coordinated, with every department of the civil and military government and each Israeli official playing a part consistent with these policies. The Palestinian newspaper Al Fajr addressed this “asymmetry of dialogue” between the Israeli government and the Palestinian population, pointing out that the struggle, which was once simply a war between competing nationalisms, had been transformed by the occupation. The relationship which emerged under the occupation was one of struggle “... between oppressor and oppressed, ruler and subject, the weak and the powerful. No meaningful and substantive dialogue can take place between these two groups under these circumstances unless the balance of power between them changed.”

“Not only is there such a great disparity in power between these two forces, but the Israelis are effectively using that disparity on a daily basis to consolidate their hold over the whole of Palestine and further weaken the Arab presence in that territory. No longer is the dispute a theoretical and ideological one over the nature of coexistence in all of the land of Palestine, but it is now a desperate attempt by the Palestinians to hang on to ‘one last acre and one last goat’.”⁶⁴

The impact of the “Iron Fist Policy” was felt in all aspects of Palestinian life. The periodic reintroduction of the “Iron Fist Policy” during the following years and its seemingly

⁶² In 1985, the occupied territories consumed 25% of all Israeli exports at a value of \$764.3 million. (Shadid, “Israeli policy” in Abed, *The Palestinian Economy*, 123).

⁶³ The Iron Fist policy was introduced by the Begin government in mid-1980 to “assure Palestinian acquiescence in Israel’s autonomy program” Aronson, *Intifad*, 213.

⁶⁴ Ibid., 224.

permanent reinstatement during the years of the Palestinian uprising, further increased the gap between the people and the Israeli authorities.

3.2 MILITARY AND CIVIL ADMINISTRATION APPARATUS:

The Israeli military government ruling the occupied West Bank and the Gaza Strip since 1967 does not derive its legitimacy through the vote of the inhabitants of those territories. Their input in the processes of governance and decision making is nonexistent. All decisive positions in this government are held by Israeli military officers. The main role of this Israeli institution has been to facilitate the extraction of economic, geographic and geological resources from those territories and to safeguard the interests of the Israeli state. This authority and its departments have comprehensively linked the two territories both economically and physically with the state of Israel, but have subjected its inhabitants to a different set of laws and regulations that guarantee their isolation from the decision making processes that shape their internal affairs and their relationship with the occupying state.

The status of the West Bank and Gaza Strip as militarily occupied territories was never recognized by the state of Israel. In 1967, the Israeli military issued military order 144, which provided the military commander of the areas with powers that annulled the applicability of the laws and regulations of the Fourth Geneva Convention on the treatment of the inhabitants of militarily occupied territories.⁶⁵ Laws that were instituted during the British mandate period remained as the bases of the legal system but were amended at the discretion of the Israeli military governor. They therefore receive no supervision and confront no challenge from any governmental or public bodies inside Israel or from within the territories. Even the Supreme Court of Israel exercises very limited authority over military decisions within the territories.⁶⁶ A different set of laws and regulations apply to the inhabitants of the Israeli settlements within the territories, more related to the legal system in use within the state of Israel.

The military commander of the the two territories has been entrusted with complete executive and legislative powers that allow him to introduce new laws and amend or cancel existing ones.⁶⁷ Since 1967, the Israeli military commander has issued more than 1,200 orders as amendments to mandatory laws and has introduced new ones, governing “legal, civil and

⁶⁵ Roy, *Survey* , 123.

⁶⁶ Ibid.

⁶⁷ Ibid.

political rights, land and water rights, licensing, taxation, services, banking and monetary activities, security and social welfare” in both territories.⁶⁸

Military orders have also been issued restricting economic activities (such as the establishment and licensing of certain industrial projects, the planting of certain crops, free trade). Other military orders have restricted fundamental freedoms (such as cultural expression, public assembly, freedom of the press and free speech, the functioning of educational and public institutions, the right of return and family reunions for Palestinians who were born in the territories but happened to be outside the country in 1967), and have controlled the mobility of the local population and their ability to enter and exit the territories.⁶⁹

The military authorities have also reintroduced preventive detention, which allows them to imprison individuals for an unspecified period without any formal charge or trial. They reinstated the deportation laws which were in use under British Emergency Regulations, allowing the permanent deportation of local inhabitants from the territories. The use of collective punishment has also been introduced, allowing the authorities to place a neighborhood, village, town or territory under a continuous curfew that usually lasts from a few hours to a number of days or weeks, paralyzing all economic and social activities within the territories.⁷⁰ The homes of individuals accused of inciting unrest or engaging in Uprising related activities are subject to demolition, leaving their entire family with no legal recourse or ability to use the same site for the reconstruction of a new residence.

The local legal system does not provide the inhabitants with any form of protection. The local courts, municipal, juvenile, magistrate and district, are virtually powerless to execute and enforce local court decisions due to the lack of judicial power entrusted in them by the military authorities. The military court holds all powers and its decisions are considered final, with very limited recourse for appeal. The Israeli High Court of Justice will accept appeals, but has rarely been able to overturn military decisions. The high cost of pursuing appeals and the lack of knowledge of the Israeli judicial system has also made it more difficult for local inhabitants to follow this course.⁷¹

One of the outcomes of the Camp David talks between Israel, Egypt and the United

⁶⁸ Ibid.

⁶⁹ Roy, *Survey* , 124.

⁷⁰ Ibid., 125.

⁷¹ Ibid., 126.

States was the establishment of the Civil Administration in both territories. This new institution took over the implementation of some laws previously introduced or amended by the Israeli military government. This process transformed those laws from the temporary status of security legislation for administering the territories, into permanent “normalized” laws that could be enforced by the newly established institution. None of the laws were amended when the transfer was made. The newly introduced department remained subordinate to the Israeli military, thus leaving in the hands of the military commander full control over all legislative, judicial and executive powers.

The Civil Administration is staffed by Israeli civilian officials employed by the various civil ministries of the state of Israel to whom they are subordinate, ultimately under the control of the military government. The Civil Administration also employs a number of local inhabitants who remain in subordinate positions to their Israeli counterparts. Many of the Palestinian staff have resigned during the initial phases of the uprising under pressure from the Unified Leadership of the Uprising, signaling the rejection of the normalization of Israeli rule over the territories.

The Israeli authorities utilized the British mandatory municipal law to structure the municipal councils of the towns and cities of the Gaza Strip, giving the occupying power full authority over the appointment and the dismissal of the municipal councils. The occupying power was thus able to put in place a municipal structure subservient to its requirements rather than the needs of the inhabitants of the city.⁷² Through this law, the military governor has total control over all decisions made by the municipal council and thus has the power to reject the municipality’s proposed projects and fund allocation plans. The local mayors or the heads of village or town councils could only be appointed by the military governor, who also possesses the power to depose them, and in most cases, replace them with an Israeli military officer.⁷³ Since the dismissal of the Palestinian mayor and municipal council in 1982, the municipality has been run by an Israeli military officer and by officials of the ministry of interior.

⁷² Roy, *Survey*, 131.

⁷³ Ibid.

3.3 TAXATION:

After the occupation of the territories, the Israeli military maintained the previously established taxation laws in both territories (the 1964 Jordanian tax laws applicable in the West Bank and Egyptian tax laws applicable in Gaza) but introduced about 177 military orders amending most to increase the taxation rates or change the collection procedures and gradually introducing a number of new tax laws aimed at increasing government revenues.⁷⁴ The taxation departments function through the civil administration authorities in both territories with links to the Israeli tax departments.

The income tax system has witnessed the highest number of amendments during the occupation period. Changes to rates, income brackets, methods of assessment and collection and appeal procedures have been introduced, all aimed at increasing government revenues from both territories. By 1985, 34 military orders had been introduced to amend income tax rates, income brackets and exemptions.⁷⁵ Tax rates were increased, with hikes ranging from 5.5% to 55%. The number of tax brackets was increased to eleven, but the maximum amount within each bracket was lowered. The maximum limit to total income under the eleven brackets was reduced to 3,768 Jordanian Dinars (JD) as compared to JD 8,000 applicable under the Jordanian law previously enforced.⁷⁶ In other words, these changes have lowered the taxable income within each bracket while increasing the tax rate. An income of JD 1,600, which used to fall under the 15% tax bracket under the Jordanian tax laws, will now fall under the 33% tax bracket. The minimum taxable income has also been reduced from JD 400 to JD 40, making it impossible for the low income earners to remain linked to the tax system.⁷⁷

Amendments introduced by Jordan to the tax laws of 1964 are not applicable to the occupied territories. In 1982, Jordan reduced the overall income tax rate from 31.4% (under the 1964 laws which were in use in the West Bank), to 13.8%. The Israeli military has also reduced personal allowances for income tax purposes.⁷⁸ In 1984, the allowance ceiling for West Bank families was established at JD 314. This is only 22% of the allowance ceiling prevailing in Jordan, and 13% of that prevailing in Israel. However, the per capita income for

⁷⁴ UNCTAD, "The Palestinian Financial Sector," 88.

⁷⁵ Ibid., 89.

⁷⁶ JD 1.00 is equivalent to \$3.00 and has declined to \$1.4 within the past few years.

⁷⁷ Ibid.

⁷⁸ Ibid.

West bank stood at 29% and 72% of the per capita income of Israel and Jordan respectively (the per capita income for the Gaza Strip is even lower than that of the West Bank).

The Israeli military authorities introduced major changes to tax collection procedures in an amendment to the 1964 Jordanian laws, resulting in the cancellation of an entire section and the introduction of a military order requiring the advanced monthly payment of taxes. The monthly installments were based on estimates of the taxes paid during the previous year and thus have no relationship to the “actual” nor the “cash” methods used for determining the payable amount for a given fiscal year. This method creates a major drain on the resources of local producers and businesses, which is further exacerbated by the lack of sufficient banking services for the local population.⁷⁹

This method of collection is also followed in Israel but the main difference is that the balance of tax due is indexed to the cost of living in Israel, while in the territories, it is indexed to the average exchange rate of the Israeli Shekel to the Jordanian Dinar. The amount of taxes collected in the territories is always significantly higher due the depreciation of the Israeli currency which is much faster than the increase in the cost of living. The same practice is followed for all other taxes where tax assessments are made in dinars, while payment is expected in shekels at the prevailing exchange rates.⁸⁰

The court of appeals, which was set up by the 1964 Jordanian law for reviewing appeals by tax payers objecting on income tax estimates, has been rendered ineffectual by a military order which transfers all appeals to a review by an “Objection Committee”. This committee passes on its recommendations to the military governor, who has the power to reject or accept the appeals. The military orders have thus “revoked judicial consideration of appeals at various levels and confined them to an administrative/military committee without judicial competence”.⁸¹

In contrast to the tax laws applicable to the Palestinian inhabitants of the occupied territories, Israeli settlers in those territories are subject to Israeli tax laws. Israeli firms that function in the territories but are registered in Israel will thus pay their taxes in Israel, while the Israeli firms registered in the territories are exempt from income tax payments. None of the taxes paid by the Israeli settlers of the territories are channeled back to those territories. Many

⁷⁹ Ibid.

⁸⁰ Ibid.

⁸¹ Ibid., 92.

Israeli firms have started to use the territories as a tax shelter. All Palestinian workers employed in Israel pay their taxes in Israel and all such tax revenues are not transferred back to the territories.

In August of 1976, the Israeli authorities introduced the Value Added tax at 8% (which increased to 15% by 1982) in an attempt to recoup some losses in revenues due to a proposal to decrease other types of taxes, as well as to generate funds for military operations against in Southern Lebanon. The proposed reductions in other taxes and the introduction of new allowances aimed at reducing the burden of the new tax on low-income families was not applicable to the Palestinian inhabitants of the territories.⁸² The residents of the territories therefore opposed this new tax and based their rejection on the Geneva Convention and the Hague Regulations, which forbids the imposition of new taxes on occupied territories. Their opposition did not lead to a change in the military decision.

All investment-related incentives that are applicable to local economic activities under Jordanian laws have been withdrawn through amendments introduced by the military authorities in both territories. Incentives for local, Arab and foreign investments in the Palestinian sector in the territories became nonexistent.⁸³ According to the UNCTAD study of 1989, Israeli investors in both territories are provided with a number of very useful incentives:

- 1) An "investment grant" equivalent to 30% of the enterprises' total investments in fixed assets.
- 2) A "concessionary loan" equivalent to 40% of the total investment in fixed assets.
- 3) Exemption for the first seven years on payment of income tax on fixed earnings.
- 4) A ceiling of 30% on corporation taxes.
- 5) Taxes on dividends to foreign investors limited to 10.5%.
- 6) The waiving of all "employers' tax" for five years.
- 7) A number of benefits on import and export activities once the firm has passed its start-up-phase, as well as aid to all research and development activities that could reach 54%.⁸⁴

⁸² UNCTAD, "The Palestinian Financial Sector," 97.

⁸³ Ibid., 98.

⁸⁴ UNCTAD, "The Palestinian Financial Sector," 99.

3.4 CUSTOMS DUTIES:

All imports by firms or individuals from the territories must be done through Israeli importers or agents of foreign firms. No local importer is allowed direct access to import sources. In 1981, the rate of customs duties levied on imported consumer goods ranged between 100-150%, while the rate for non-consumer goods was around 40%. These same rates are applicable to Israeli importers, but local firms pay an additional 15% VAT to Israeli importers or agents, as well as an additional percentage in commissions.⁸⁵ According to a study done by UNCTAD in 1989:

“ The overall objective of this policy has been to safeguard Israeli products and influence the general level and pattern of the territories’ imports from abroad. While there may be an economic justification for such duties to be applied on imports into Israel, the same cannot hold for the occupied territories. Israeli customs duties may be aimed at protecting domestic Israeli industries in which the occupied territories have no interest. As such, the payment of such duties by importers in the territories represents not only a participation in the protection of Israeli economic interests but also a contribution to Israeli government revenues. In 1985, Israel supplied 89% of the territories’ imports from the rest of the world while Jordan provided 9%, equivalent to a combined total of \$659 million worth of goods. The contribution to the Israeli government revenues from customs duties and from VAT on such a volume of trade cannot be underestimated.”⁸⁶

All goods imported for Palestinian firms or businesses are required to be transferred to bonded warehousing while they are being cleared and checked by security officials. The local firm is responsible for all fees involved in such operations as well as storage fees.

All the above listed tax regulations are enforced by the military government through the departments of the civil administration. The input of the Israeli civilian ministries in the implementation and decision making process is therefore very limited, and is usually up to the discretion of the Israeli military governor of the two territories. Even if the civilian ministries had increased input in the processes of governance, the lack of significant local Palestinian representation will always result in decisions giving the Israeli state and its citizens the advantage. The ability of local staff members to provide a vehicle through which local

⁸⁵ UNCTAD, “The Palestinian Financial Sector,” 94.

⁸⁶ Ibid.

inhabitants could bypass some of those regulations and laws has been very limited and confined to very few areas where they will have to eventually confront Israeli officials from the civil or military authorities. The number of the local staff has also declined considerably during the uprising reducing any chance of bypassing even the minimum of hurdles.

IV - MICRO LEVEL DISCUSSION: Case Studies.

4.1- Description of Cases.

4.2- Pattern of Industrialization:

. Impact of Shifts in Israeli Policy.

4.3- Structure of Control:

. The Implementation of Restrictive Regulations and Practices.

4.4- Pattern of Production Processes.

4.1 DESCRIPTION OF CASES:

1- Textiles Production, Est. 1974:

This firm was established during the second phase of occupation in 1974.⁸⁷ It confronted no difficulties in obtaining its municipal or production licenses and has remained formally registered ever since. It was established as a partnership between three extended families and maintained the partnership until the years of the uprising when production declined and the firm was incapable of supporting the three families. It specialized in the production of textiles for sale mainly in the local market of the Gaza Strip and the West Bank, with a small percentage of its sales going to Israel through subcontracting for Israeli firms. It targeted traditional, well established demand in the local markets, and did not venture into new lines of production or import substitution.

This firm relied on capital accumulated through trade activities during the initial years of the occupation, funds generated from other extended family assets, and on-going branch production and trade activities conducted by members of the extended families. The initial fixed-capital investment was below \$50,000 due to the purchase of used machinery, but increased to over \$800,000 after the introduction of new machinery. The cost of construction of the main plant was \$120,000.

Family labor provided the core of the labor force during the initial and uprising phases. External labor, except for a few highly skilled workers, was considered too mobile for the firm to invest in. This firm employed 25-30 workers during the peak years of its production in the late 1970's and early 1980's, 40% of whom were family members. Most technology transfer and investment in human capital improvement was channeled to the family labor force first and the highly skilled external workers second. All administrative positions were held by members of the extended families, thus limiting the firm's potential to the capabilities of those family members.

During the initial years of production, the firm invested in low priced, second-hand machinery that it obtained from the Israeli market. This was done to reduce the initial capital investment and minimize the initial risks. New machinery had to be introduced at a later stage, when the production process became well established and mastered by the labor force and a

⁸⁷ See Chapter Two, Section 2.3.

stable market niche was guaranteed. The new machinery was essential to give this firm a competitive edge against its Israeli competitors in targeting the local market.

The firm imported all of its required raw materials directly from its external sources but was forced to rely on an Israeli import agent to handle all import procedures in order to avoid confrontations with customs and port officials. The control over the import operation was gradually lost to the Israeli agent after the the amount of materials required by the firm began to decline during the years of the uprising and as border crossing regulations became more stringent.

During the years of the uprising, production levels dropped by 70%, because of the decline in local consumption and the increased difficulty of access, to the markets of the West Bank and Israel. This firm was forced to relocate a segment of its production activity to the residence of one of the extended family residences in an attempt to avoid work disruptions during strike and curfew days and to avoid taxation raids that used to occur on the more exposed main plant. The percentage of family workers increased during this phase in an effort to reduce production cost, while the number of external workers declined to a minimum. Members of the extended family began engaging in informal, small-scale branch income generation activities alongside this line of production, to introduce alternative sources of income for the expanding extended family.

2- Textiles production, Est. 1985:

This textile production activity existed during the period of Egyptian administration, but was forced to shut down because of the loss of links to its traditional markets after the occupation of the territories. During the transitional phase after occupation, the members of this family established a trading business, specialized in the sale of used cars purchased from Israel. The extended family began witnessing a decline in their trading business and decided to venture back into their previous production activity. The new textile production plant was established during the third phase of occupation in 1985.⁸⁸ The firm confronted many difficulties in obtaining its municipal and production licenses. Both local municipal council and Israeli Department of Trade and Industry delayed the issuance of these licenses for a year from the time that the application was submitted. The firm experienced harassment from the military

⁸⁸ See Chapter Two, Section 2.3.

authorities which pressured it to stop its production activity. The firm also faced a coordinated effort by competing Israeli textile producers to stop its attempts to purchase second-hand production machinery from Israeli sources.⁸⁹

The firm relied on funds generated through the previously owned used car retail business and other personal family assets. Its owners introduced modern machinery from the initial phases of production, in order to give the firm the ability to compete for sale in the local market with the modern local firms which were already established and with Israeli firms and to gain access to niches in Israeli markets. The Fixed-capital investment by this firm reached \$500,000 after the introduction of a dyeing plant. One hundred thousand dollars in working capital had to be available at all times in order for the production operation to function smoothly because of this firm's inability to gain access to deferred payment plans from its Israeli suppliers of machinery and raw materials.

When production commenced in the later part of 1985, the firm directed its production toward import substitution and the introduction of new lines of production that showed sale potential in the local market. The firm adopted this approach because the local market for traditional goods was saturated by the numerous local producers, and the only potential for entry was in this kind of experimentation. Through the addition of a dyeing and finishing component to its system of production, the firm was able to reduce its dependence on the Israeli textile sector for those operations. This allowed this firm to gain an edge over both local producers and its Israeli competitors.

The firm initially relied on family labor but had to introduce external wage labor at a later stage. The number of workers approached 20 (25% family workers) during the peak years of production, but declined to 8 (50% family workers) during the uprising. Technology transfer and administrative operations were held by family members while external workers held transitional lower level positions.

The decline in the level of production witnessed by this firm during the years of the uprising (50%) was significant but not as radical as the decline experienced by other local textile firms. The flexibility of this firm's production line and its ability and willingness to venture into untested lines of production, as well as the completeness of its production system and thus its limited reliance on other sectors within the Israeli economy resulted in this

⁸⁹ See Chapter Five, Section 5.4.

outcome.

Most of this firm's activities remained formal and fully registered during the years of the uprising. Formal links with Israeli importers of raw materials and machinery had to be maintained, forcing the firm to maintain the formality of most of its other transactions. However, the firm tries to take advantage of informal transactions whenever possible.

3- Sewing/Subcontracting -Est. 1967:

This firm was established during the initial phase of occupation in 1967.⁹⁰ It faced no difficulties in obtaining municipal and production licenses and was able to obtain the required travel permits to Israel. This allowed it to construct contacts with the various Israeli parent firms and sources of machinery and technical assistance. This firm specialized in the assembly of men's trousers which were delivered to it by the parent firm in the form of unassembled components. Fifty percent of the final products that were processed by this firm were then marketed by the parent Israeli firm in the local markets of Gaza and the West Bank, while the remainder was sold in Israel or exported.

The links with the Israeli firms provided this firm with a measure of protection against the practices of the Israeli authorities in the territories but have limited its links with the local economy. This firm has developed very few relations with local sources of machinery, maintenance or raw materials and none with local markets. The firm was able to guarantee stable links with the Israeli parent firm as a result of the long duration of the relations between them.⁹¹ The drawbacks of the character of this firm became more apparent when links with the Israeli economy became more vulnerable.⁹² This firm maintained its isolation and continued to rely on its previously established Israeli links. The firm maintained a formal status throughout its years of operation. This status was not altered during the years of the uprising and thus totally exposed its economic transactions to the local authorities.

The labor force of this firm was specialized and functioned on an assembly line format. Thus individual workers did not develop the full range of production skills. The labor force

⁹⁰ See Chapter Two, Section 2.3.

⁹¹ The establishment of subcontracting relations with Israeli firms at the initial stage of the occupation contributed to the evolution of a stable relationship with the Israeli parent firms.

⁹² The lack of links between this firm and local producers, retailers and sources of materials and its lack of familiarity with local demand made this firm vulnerable to any disruption in links with the Israeli parent firms.

was mostly external, with limited levels of skill. The firm employed 25-30 workers through its years of operation. The number of workers has not declined during the uprising, because the firm was able to locate additional sources of business with other Israeli firms.

The firm relocated to the owner's place of residence in a residential neighborhood of the city. The relocation occurred in 1982, in an attempt to reduce overhead costs. Because of its limited links with the local economy, it did not require proximity to local markets, sources of materials or other firms.

4- Sewing/Subcontracting-Direct Production, Est. 1974:

This firm was first established during the first phase of occupation in 1967 as a clothing retail operation. The owner was imprisoned for political reasons for a five year period (1969-1974). After his release in 1974, he became involved in subcontracting activities with links to a number of Israeli firms. The firm did not confront difficulties in obtaining the required licenses during the first phase, but faced increasing difficulties during the second, as a result of the owner's security record. The owner was imprisoned again in 1979 for similar accusations and was released in 1985. The firm was liquidated by the authorities during that period of imprisonment and its machinery and materials confiscated. After his release in 1985, the owner was unable to register the firm in his own name and had to use his nephew's name as the main applicant for the municipal and production license.

During the second phase of its operation (1974-79), the firm employed 35 workers and had links with a number of Israeli firms. During the third phase of its operation, the firm employed 15 workers and began finding it more difficult to establish or maintain links with Israeli firms as a result of the saturation of the market by local subcontracting firms in the same line of production. The firm lost all its subcontracting links with the Israeli firms during the years of the uprising because of the instability of those links and increased difficulties at border crossings.⁹³ The owner began facing difficulties obtaining taxation clearance and border crossing permits due to his past security record and was thus unable to maintain sufficient links with Israeli firms.⁹⁴

⁹³ Subcontracting links that were established at a later stage were not as stable as the earlier ones.

⁹⁴ The difficulties confronted by this firm in the mid-1980s reflects the increased obstruction of the previously less restricted local production activities (subcontracting for Israeli firms) which is reflective of a shift in Israeli policies.

During the years of the uprising, the firm attempted to redirect its production activity towards the production of finished goods for direct sale in the local market. This was not successful because of the limited local demand and insufficient understanding of the local market. The firm finally went out of business in the summer of 1990 and the owner became an employee with a local institution.

5- Sewing/Subcontracting & Sewing/Direct Production Tailoring- Est. 1980 & Pre 1967:

The main tailoring shop was established by the father of the current owners, prior to 1967. The eldest brother received his training from his father during the 1960's and took over the tailoring shop after the death of the father. The shop was registered with the municipality and did not require a production license. The tailoring shop flourished during the initial years of occupation because of the increase in local consumption driven by an increase in income generated through employment in Israel, trade with the Israeli economy and transferred remittances from Palestinian labor force employed in the surrounding Arab region. However, this business was seasonal, reliant on the return of Palestinian students from universities during the summer months and the occurrence of marriage celebrations during the same season. Business declined by 50% during the winter months, forcing the second brother involved in the tailoring firm to branch out and establish a sewing firm with subcontracting relationships with Israeli firms. This shift occurred in 1980.

The production processes carried out by the two operations were considerably different. The tailoring branch produced men's custom clothing by the unit, while the new branch used an assembly line system for the assembly of the semi-processed items it received from the Israeli firms. The new branch owner had to readjust his previous training for the new operation and acquire new skills in worker management and the organization of the production line. Through the subcontracting relations, the new branch gained access to technical innovations in production and exposure to new materials and sewing processes which it was able to pass on to the tailoring branch.

During the uprising, and with the boycott of Israeli produced clothing, the tailoring branch made a shift towards mass production of clothing for sale in the local market, utilizing

the knowledge it had acquired through the subcontracting branch.⁹⁵ The subcontracting branch was able to maintain its links with the Israeli firms and establish new links with others to compensate for the loss of business due to the decline of local and Israeli demand during the years of the uprising.

The tailoring branch therefore benefited from the changing conditions during the uprising and was able to capitalize on its existing and well established links with the local market to expand and stabilize its operations. The tailoring branch remained functioning at the informal level, while the subcontracting branch was linked totally to the formal system. The formal status of the subcontracting branch allowed it to gain access to formal sources of materials and machinery. This came in very handy for the tailoring branch which would have otherwise been limited to the local informal market.

The tailoring firm maintained the use of a rotating work system through which all workers gained exposure to the various phases of production (employed 15-20 workers after the shift). The skill level of the majority of the workers remained high and most of them remained committed to the firm for a long period of time. The subcontracting branch however, used the assembly line processes of production and the specialization of the workers in specific tasks (employed 20-25 workers during the years of the uprising). The general skill level of the labor force remained relatively low and the workers tended to leave the firm in search of better employment opportunities.

6- Basic Metal Products- Appliances (Heavy) Est. 1968:

This firm was established during the initial phase of occupation in 1968.⁹⁶ The initial shop specialized in the maintenance of electrical appliances and maintained a municipal permit for its operation. No production license was required for maintenance shops. It is owned by an extended family but run by one member of that family. Through dealing with appliances and gaining access to the local branch of the UNRWA technical school, the owner acquired the experience necessary to begin in-house production of some of the simpler appliances with high

⁹⁵ The custom tailoring branch utilized the assembly line system of production which was used and perfected by the subcontracting branch. This transformation of the production process allowed the tailoring branch to increase its scale of production while maintaining the flexible qualities of its previous production process.

⁹⁶ See Chapter Two, Section 2.3.

local demand. The shop began producing transformers, welding machines, metal shelves, and a series of metal products for sale in the local and West bank markets, and gradually in Israel. The firm maintained its registration as a maintenance shop in order to avoid the payment of the production tax until it was forced to register as a producing firm in the early 1980s.⁹⁷

At that point, the firm began establishing links with formal sources of materials and machinery in Israel and established formal channels to the local and Israeli market. It developed formal links to Israeli machine shops through which the firm gained more production experience. The firm thus maintained very flexible production processes, shifting to different lines of production when demand developed and saturation of the previous line of production occurred.

The firm relied to a great extent on second hand machinery it acquired from Israel. The firm conducted all the modifications on the machinery in-house. During its years of operations, the firm became more self reliant with most of its production and maintenance operations done in-house. However, it was forced to maintain some links with modern sector machine shops in Israel for the production of the more precise items as well as the items that were required in larger quantities. Still, the firm was able to develop extensive local market links in both territories and gradually in Israel. The capital investment in machinery and modifications to it reached \$800,000 to \$1.2 million by the year 1990.

In 1985-86, the firm ventured into the production of gas canisters which are widely used by every household in the territories and Israel. With this product, the firm went into direct competition with a government supported Israeli firm producing the same item. This step brought the firm in direct confrontation with the various local departments of the Israeli government and institutions of the state, including the supreme court. The owner was imprisoned a number of times by the Israeli military by the request of the Tax and Interior Ministry departments, in attempts to make the firm abandon the new line of production.

During the uprising, the product of this firm saturated the local market, overtaking the gap left by the Israeli producers after the boycott of Israeli goods was introduced in the territories. The firm tried its utmost to maintain its formal status so that it could access required sources of raw materials and the markets of the West Bank and Israel. During the uprising,

⁹⁷ Most local informal production activities were forced to formalize their status through an intensified surveillance process at border crossing and raids on production plants.

this firm has expanded considerably, and began marketing its products in Israel as well as in the local markets, despite of all the continued opposition and active harassment of the authorities. I attribute the success of this firm to a number of factors:

- 1- The existence of sufficient local demand for the product (due to the backing of local production during the uprising as well as the fact that its main product is a basic consumer item with a stable source of demand) which allowed the firm the required financial support to maintain its formal status and the continued links to formal sources of materials, machinery and other services. The ability to sell its products in Israel also contributes to its financial stability.
- 2- The extensive understanding of local demand and the ability of the firm to maintain a high level of production line flexibility.
- 3- The ability of the firm to use second hand machinery for the production of modern sector consumer products through in-house modification. This factor contributed to a considerable reduction in the firm's overhead and increased its competitive edge significantly.
- 4- The most important factor of all is the stamina and determination of the owner, who persisted despite overwhelming confrontations from the entire government operations.

7- Basic Metal Products- Electrical Components, Est. Pre-1967:

This firm was established prior to the occupation of the territories and specialized in the production of electrical components for household and commercial electrical systems. It was registered as a production plant during the initial phase of the occupation and has been able to maintain its registration formal status ever since. It was run by the father of the extended family and was taken over by the eldest son, who is an electrical engineer, after the death of the father in the mid 1970s.

8- Basic Metals Products- Light Appliances -Est. 1975:

This firm was established during the second phase of occupation in 1975.⁹⁸ It did not face any problems in obtaining a municipal license, which allowed it to function as a maintenance shop, and did not require a production license. This firm is owned by members of

⁹⁸ See Chapter Two, Section 2.3.

an extended family and is run by one of its members. The family member in charge of the production and administration of this operation gained his training from the local branch of the UNRWA technical school in air-conditioning and refrigeration systems (a two year program).

The operation remained limited in size for the initial few years and specialized in the maintenance of electrical appliances. The initial capital investment was kept at a minimum during the early phase but was gradually expanded to approximately \$50,000 in machinery and an equivalent amount allocated as working capital. Through its work in maintenance, the firm was able to gain a great deal of knowledge about the weaknesses of the imported and Israeli produced appliances that are sold in the local market.⁹⁹ The firm began venturing into flexible production processes, manufacturing a variety of simple electrical and other home appliances for sale mainly in the local market and, to a limited extent, in Israel. Demand for the various items was seasonal, forcing the firm to shift its production according to changing demand patterns. Imitation of products by other local existing or newly established firms forced this firm to constantly look for new potential items.

The operation was mainly informal during this period, with links to local and Israeli informal sector activities. Some portion of the operation fluctuated between formal and informal, depending on the level of surveillance by the authorities and the rewards gained if formal links were created. In many cases, formal links were established with Israeli suppliers of raw materials. The firm relied on the constant supply of trainees from the UNRWA technical school as the main source for its labor force. It was able to reduce its overhead by hiring 50% of its labor force from students in training at half the pay of a regular worker. The other 50% were graduates of that technical school who were responsible for training the new workers. The firm had a high worker turn-over. The average period of time that a worker remained with the firm was 2-3 years. Most left in search of better paying jobs in Israel or outside, or established their own production or maintenance shop.

In addition to its diversified seasonal line of production and maintenance operations, the firm began producing spare parts for a popular type of electric washer for use in its maintenance operations. The firm began to acquire secondhand machinery for the production of the various parts of this washer. By 1987, it had accumulated the capability to produce all

⁹⁹ The influx of second-hand appliances to the markets of the territories from Israel provided local maintenance shops with ample business and opportunity for experimentation. Most of these firms capitalized on their experience for the establishment of future production activities.

the components needed for the full assembly of the washer. The firm also developed a successful technique for the rewiring of used electric motors that it acquired from scrap or second-hand sources in Israel. The production line of the washer was fully functional by late 1987, a few months prior to the start of the uprising.

In its design of the new washer, the firm tried to resolve all the problems that became apparent in the imported models and was able to sell its unit at half the price of the imported unit. The target market was the lower income groups in the territories who were dependent on the supply of second-hand appliances from Israel.

This firm has been able to expand its production activity during the years of the uprising, due to the decline in competition from Israeli second-hand or imported products that used to flood the local market. Its understanding of local demand, and the elaborate system of contacts it established with the local economy and other local firms enabled this firm to make the transition. The operation became totally informal during the uprising, relying on informal local and Israeli sources of raw materials and machinery. This has created a number of limitations for the firm, but provided it with the necessary invisibility from the taxation authorities and other government agencies.

9- Basic Metals Products- Light Appliances. Est. 1980:

This firm was first established as a maintenance shop during the second phase of occupation in 1974.¹⁰⁰ The owner was a graduate from the UNRWA technical school in the maintenance of electric appliances and refrigeration. This first attempt failed as a result of the saturation of the local market with such shops. The owner had to seek other employment opportunities in Israel. After 6 years of work with a refrigeration production firm in Israel, the owner was able to gain the required experience and market contacts to establish an independent commercial refrigerators production activity in Gaza. The new firm was opened in 1980, during the later part of the second phase of occupation. The firm obtained a maintenance and assembly license from the municipality and began the production of the units for sale in Israel, capitalizing on its low production costs and low overhead, which gave it a good competitive edge over Israeli competitors. A very small percentage of the firm's production was sold in the

¹⁰⁰ See Chapter Two, Section 2.3.

Gaza Strip and the West Bank, due the small number of local activities such as restaurants large scale fish and meat markets of modern supermarkets requiring such refrigeration units.

The initial capital investment in machinery and equipment was relatively low (\$20,000) and was maintained at that level for the duration of the firm's operation. The firm utilized second hand machinery and relied on manual labor intensive operations in its production line. The firm located in rented facilities within mixed-use zones of the city, but was forced to relocate to an unregistered location during the uprising, in an attempt to avoid the frequent taxation raids.

The firm established only limited links with the local economy except for some subcontracting relations with local firms which supplied it with some of the items used in production. Most of its links to sources of raw materials were with Israel. Most of the firm's links and activities were informal, bypassing most government and taxation surveillance systems. The situation began to change in the mid-1980's, when surveillance methods were intensified and all border crossing check-points targeted the flow of goods between the territories and Israel. At that point, the authorities introduced a law requiring the payment of production tax by all production, assembly and, in many cases, maintenance operations in the territories. Entry to Israel became conditional on the firm's payment.

The advent of the uprising was devastating for this firm and resulted in an 80-90% decline in its level of production. The firm lost its access to the Israeli market due to its inability to maintain the taxation clearance papers needed to enter Israel or the West Bank. Israeli firms that were originally involved in the same line of production and were pushed out by local producers were able to resume production and fill the gap left by local firms. The firm attempted to redirect its production line towards local demand by producing a small scale household refrigeration unit but was not successful in doing so.¹⁰¹

The number of workers declined from eight to two, leaving the two brothers as the main labor force after the uprising. The eldest brother was imprisoned during the summer of 1990, accused of involvement with the neighborhood popular committees.

¹⁰¹ Even though this firm utilized relatively flexible production processes, its specialization in the production of one item and the rigidity of its market links made the transition very difficult.

10- Cosmetics Production. Est. Prior to 1948:

This firm was originally established in the city of Jaffa prior to the establishment of the state of Israel in 1948. It was forced to relocate to the city of Gaza after the expulsion of the Palestinian population from the city in 1948. The firm relied on the demand generated by the free trade zone status of the Gaza Strip during the Egyptian administration period. During that period, local producers were able to gain access to the markets of Egypt and surrounding Arab markets. The production activity was disrupted after the occupation of the strip by Israel in 1967 and its disconnection from its traditional markets. Nevertheless, the firm was able to redirect its sales to the local markets and gradually establish links to the markets of Israel and the West Bank.

The firm is owned and run by the members of an extended family (father and three children), making-up 20% of the labor force. The main technical capabilities and all the administrative operations are limited to family workers while external workers tend to be lower skilled and relatively mobile.

The firm was able to maintain its strong links with the external suppliers of raw materials, machinery, equipment and technical transfer. Those links were further strengthened through annual personal visits by the firm's owner during the years of the uprising. The stability of these relations helped this firm to avoid the reliance on Israeli producers or import agents for acquiring such supplies. Thus, it was able to maintain control over the deferred payment plans offered by the European producing firms and lower prices on the purchased supplies. The firm was also able to develop extensive external links to suppliers of machinery and sources of technical assistance. It has developed minimal links with the local and Israeli productive sectors, but has marketed 60% of its total products in the territories while the remainder is sold in Israel. The firm has not been able to gain access to export markets due to the overwhelming requirements by the Israeli departments for gaining such access.

Throughout its operation, the firm maintained formal status with the Israeli taxation departments because of its need to maintain undisrupted contact with European suppliers. Its ability to guarantee a stable niche within the local and Israeli markets (sales were made to Palestinians in Israel), provided it with sufficient financial backing to maintain an up-to-date and clear record with the authorities.

During the uprising, the firm witnessed a considerable decline in the sale of its luxury

products, while it witnessed a considerable increase in the sale of its basic essential goods as a result of the boycott of Israeli goods in the local markets. Even though the firm has maintained accurate accounts, it has begun facing increased difficulties in obtaining tax clearance and has on many occasions been forced to pay overestimated tax payments. The firm's delivery truck was confiscated a number of times by the military, for use in raiding refugee camps, resulting in the destruction of the vehicle and the disruption of delivery activities.

4.2 PATTERNS OF INDUSTRIALIZATION: Impact of Shifts in Israeli Policy.

Introduction:

Several categories of firms evolved within the Palestinian industrial sector during the years of occupation, shaped by the shifts in Israeli policies in the territories. The response of firms to the imposed restrictions and the changing conditions was markedly different in each category. The character of each category also changed in response to changes in policy and the intensification of restrictive practices. In the following section, I will discuss the consecutive phases that characterized the occupation period during which local firms evolved, and the shifts in policy and conditions under which such firms had to function. I will then discuss the pattern of responses to the consecutive phases and policy shifts by the various firm categories. This description will be based on the experience of the interviewed firms.

Firm Response to Phases and Policy Shifts:

During the initial phases of occupation, the ability of local production firms that existed prior to the Israeli invasion of the territories to continue functioning was limited considerably due to the break in links between such firms and their traditional markets, sources of formal funding, and raw materials.

1- The disruption of physical and economic links with Egypt after 1967 resulted in the collapse of most segments of the local economy which were reliant on those links. Production activities that evolved as a result of demand in the Egyptian markets and the opportunity provided by the tax-free zone status of the Gaza Strip during the Egyptian administration were forced to shut down or reduce their scale of operations. The confinement of such firms to the limited market of the Gaza Strip, the collapse of the local Arab banking system, the scarcity of credit at the advent of the Israeli occupation and the lack of understanding of the Israeli and West Bank markets, forced most to abandon production activities and engage in a process of one-sided trade with the new economies (those of Israel and the West Bank) targeting local demand for consumer goods produced outside the Strip .

The flooding of the markets of the two territories with Israeli produced low quality consumer goods during those initial years, further complicated the situation for such firms and presented them with a source of stiff competition, resulting in their paralysis or marginalization. Access for these firms was limited to a small segment of the low-income demand in their local markets, and the size of their share in that market was reduced further as the scope of the sale of Israeli goods expanded. The lack of credit availability due to the rupture of the local financial system during the initial phases of occupation, curtailed their ability to upgrade their production activities and increase their competitive edge.

The owners of such firms had very little contact with the Israeli economy and its productive sectors and thus had limited access to the new sources of technical transfer through which they could introduce improvements to their out-dated production processes.¹⁰² Most of their links were with the remnants of the limited local productive sectors that existed prior to the occupation.

Therefore, this initial period witnessed considerable growth in one-sided trade activities between Israel and the territories, further impeding a process of identification of new directions for most existing local production firms, and made the establishment of new local firms targeting local demand very difficult. During this initial period, the political uncertainty in the territories and the lack of clarity of the new economic situation, pushed the local population towards the establishment of temporary economic activities, mostly linked to the Israeli economy and the opportunities it offered and away from investments in long term local economic activities.

2- This firm is owned and run by the members of an extended family in the Gaza Strip who was involved in textile production during the Egyptian administration period prior to 1967. This extended family was unable to continue with the same activity after occupation as a result of the loss of access to the Egyptian market and the decline in generated capital. During the initial years of occupation, the market of the Gaza Strip offered a limited outlet for the products of the firm which, during the period of Egyptian control, relied a great deal on Egyptian consumers who flocked to the Gaza Strip which was designated as a tax free zone during that period. The older children joined their father in establishing a used car business in the Strip in 1968-69, relying on secondhand cars acquired from the Israeli market. The used car business flourished in the occupied territories until the mid or early 80s when it began witnessing a noticeable decline as a result of a general economic slow down in the territories and Israel.

Some of the remnants of previous production activities serving the basic and stable

¹⁰² Most of these owners were from the merchant classes and thus did not seek employment in Israel.

segment of local demand continued to function during this transitional period, in the form of small-scale workshop activities. Such firms provided services in the maintenance of electrical appliances, automobiles, mechanical equipment, machine shops, and the production of confectioneries and custom tailoring. The scale of these types of activities remained small during this phase, but some began expanding as the local market stabilized and demand patterns became more defined. A tailoring firm which existed prior to the Israeli occupation of the territories was able to make the transition and capitalize on the increase in the income of the local population during the initial phase. The wide spread trade activities during this initial phase as well as direct employment in Israel and Palestinian workers' remittances from abroad resulted in a considerable increase in the rate of consumption within the two territories.

3- During the initial period of occupation in the early 1970's, the owner was able to attract a great deal of business from the younger population of university students who attended Egyptian universities during the year and came home to Gaza during the summer months. The firm also attracted an increasing number of workers who were employed in Israel and were earning relatively high salaries. During that period, the firm became very popular in all parts of the Gaza Strip, and specialized in the production of suits and trousers.

Workshops and production activities of that nature however, quickly saturated the local market. Many of their owners were forced to move towards trade or direct employment in Israel in order to continue making a living.

6- After his graduation from the local UNRWA technical training school in 1986, the owner established a shop for the maintenance of electrical appliances. This attempt failed soon after due to the increasing number of similar shops in the city which forced the owner to seek employment at a refrigerator maintenance shop in Israel for a period of four years. There, he was able to develop his skills and make contacts with Israeli manufacturers of commercial refrigerators. Through his experience in Israel, he was able to gain the knowledge required for the production of those units and was also able to make the contacts required for the future marketing of the units he produced.

One of the few production activities that began to appear during that initial phase was based on recently established subcontracting relations with Israeli firms, and concentrated in specific subsectors of the local economy, particularly textiles. Those firms chose this line of activity in response to the state of economic confusion in the territories during that period and the difficulty for local firms to evaluate the characteristics of the new and unpredictable market trends. This choice also enabled firms to bypass the initial formal restrictions placed by the authorities, aimed at preventing access for local firms to the markets of the Israeli state and the reduction of local sources of competition for Israeli firms in the local markets.

In the subcontracting arrangements, the requirements of the Israeli firms were clear, and the role that they required local firms to play was limited and well defined. All the necessary inputs for the production process excluding labor, were provided by the Israeli firms, thus allowing local firms the ability to bypass the major vulnerability of the local economic conditions.

During that initial period, the Israeli authorities actively supported the development of firms that provided useful services for the Israeli productive subsectors, and did not present a source of competition for Israeli firms in local or Israeli markets. Such firms were provided with access to formal credit through the newly established branches of Israeli banks as well as governmental loans, while numerous formal restriction on the development of local firms that could have represented a source of competition for any Israeli firms were implemented by the authorities.

5- In order to facilitate its access to Israel , this subcontracting firm obtained a commercial travel permit renewable every three months which allowed the owner to gain access to Israel 24 hours a day. This allowed him to establish business relations with some clothing producers there. The permit was issued by the department of trade and industry with relative ease. The firm was registered by the department of trade and industry and obtained a production number and opened an income tax file since the beginning of its operations in 1968. At the beginning of the period of occupation, local producers and businessmen were invited by the military administration through the department of trade and industry, to attend an industrial exhibition in Israel in order to generate ideas about new lines of production that they could establish in the territories.

10- This textile production factory was registered as a production plant from the outset and registered for the payment of production tax on all its production. The firm obtained a license from the Municipality of Gaza and the Israeli Department of Trade and Industry. The firm faced little difficulty in obtaining the license from either authority. That was in the early 70s.

Local entrepreneurs were granted permits for the establishment of production activities that were based on subcontracting for Israeli firms or producing goods that could be purchased for export or local marketing through Israeli state controlled marketing boards.¹⁰³ All permits required for the establishment of production activities that directly targeted local or Israeli demand and thus presented a viable source of competition for Israeli firms were denied. Firms that could have specialized in the processing of the surplus agricultural production of the territories for local markets or direct export were not allowed to function. This was done to preventing competition with Israeli exporters in external markets and sale in local markets.

¹⁰³ Citrus packing houses were allowed to operate and were only able to market their product through the Israeli Agricultural Export Company (AGREXCO). Direct access for local agricultural producers to markets targeted by Israeli producers was not permitted.

Formal access to the Israeli market for most industrial and all agricultural products from the territories was obstructed. On the other hand, full formal access to the local markets was granted to Israeli industrial and agricultural producers, transforming the territories into dumping markets for most Israeli low quality agricultural and industrial products.

The interaction of local merchants with Israeli producers and retailers during this phase, as well as the direct employment of the local labor force in the Israeli economy, created a better understanding of the characteristics of the evolving local markets and the gaps within the Israeli market. At that point, local entrepreneurs began venturing into the establishment of production activities targeting local demand, niches in the Israeli market, or a combination of local and Israeli consumption.

This marked the second phase of development of local firms in the territories. The period spanning the late 1960's and early 1970's therefore, began to witness the development of a number of local firms in various subsectors. The funds generated in the local economy during the initial phase through retail and trade activities with the Israeli economy, direct employment in Israel during the initial years of occupation, and remittances from Palestinian workers in the surrounding Arab regions, provided a good source of capital for these new production activities. No formal sources of credit were used to fund these new activities due to the suspension of suitable credit facilities by local branches of Israeli banks, and a lack of intervention from local or international institutions.

Beginning in the early 1970's, the Israeli authorities realized that they were becoming increasingly unable to maintain the desired control over the pattern of development of local production activities. This became apparent when a number of small informal production activities that had bypassed most of the formal restrictions and gained unsupervised access to the Israeli and the local economies, began to appear in the territories. These informal activities became the nuclei for larger more formal firms which evolved as access to markets and to formal and informal sources of credit became more stable, and as their links to raw materials, labor and technology transfer were developed. The newly evolving local firms began to present Israeli productive sectors with some source of competition in both local and Israeli markets. They were able to capitalize on their access to low cost production activities and, in certain sectors, comparable production quality based on technical knowledge and production innovation that they had acquired from their interaction with Israeli firms through direct

employment or subcontracting relations.

At that point, the Israeli authorities began imposing general restrictions on all local production activities by escalating the restrictive policies governing the mobility of Palestinian goods and individuals between the territories and the refusal of establishment permits to all potentially competitive firms. Formal access to credit through government and bank branches was suspended. Local branches of Israeli banks suspended their long and medium term loan programs, and reduced their services to only facilitate daily transactions between the territories and Israel, making them suitable only for trade and other short term financial operations with the Israeli economy. The Israeli port facilities and customs departments intensified their security checks and inspection of all goods imported by local producers or retailers, causing excessive delays and reducing the feasibility of direct import operations for local entrepreneurs. Higher tax rates were introduced, coupled with more stringent collection procedures.

All the above restrictions, the suspension of formal support for a general process of economic development in the territories, and the increased hostility by the departments of military government to local producers, was aimed at counteracting any new pattern of independence that was beginning to emerge within the local economy, and to re-establish its dependence on the Israeli economy.

The links that some local firms were able to establish at an early stage with Israeli firms through subcontracting provided continued protection, while other local firms with no such links, were left to face restrictions and practices on an individual bases. Many local firms resorted to creating protective links through linking a segment of their activities with formal Israeli firms or sectors in an attempt to bypass the newly imposed restrictions and to reduce their confrontations with the authorities.

3- The firm employed an Israeli import agent for the handling of import and port procedures on the Israeli side on their behalf. This was done in order to avoid difficulties with the port and customs officials, and to bypass the difficulties involved in obtaining an import/export license.

Instead of directly importing their required raw materials and risking confrontations with Israeli port officials and customs departments, such firms hired Israeli import agents to handle their import operations. Others hired Israeli machinery buyers to gain access to sources of used manufacturing machinery, thus bypassing coordinated opposition to such purchases by Israeli competitors. Others established stable links with Israeli retailers for the marketing of

their products. All such arrangements were based on purely commercial relations and were thus maintained as long as they proved economically feasible for the Israeli partners despite the formal governmental opposition to such activities.

A number of other local firms on the other hand, reduced their confrontations with the Israeli authorities through adopting informal links with local and Israeli sectors, becoming invisible to the authorities and thus bypassing their restrictive regulations. During this phase, supervision of informal activities by the authorities was not well developed. This situation allowed firms to establish and maintain informal links with Israeli and local markets. Border inspection of the flow of industrial goods from the territories to Israel was not regularly inspected thus allowing local informal producers easy access to external markets in Israel and the West Bank.

The 1980's witnessed a further intensification of surveillance of local economic activities, an increase in bureaucratic regulations and the introduction of new tax estimation and collection procedures. The taxation authorities introduced two new types of taxes, the VAT and the Production tax, on all local production activities. Local producers and retailers began facing more frequent taxation raids on their premises and at border crossings in an attempt by the authorities to link most local producers with the taxation system and to formalize as many local production activities as possible. Access to the markets of Israel and the West Bank became more aggressively monitored along border crossings. Transactions through local branches of Israeli banks as well as with Israeli firms, suppliers of raw materials and retailers became more closely scrutinized and a system of communication was introduced between all taxation and customs departments to keep track of all economic transactions of individual firms within the local economy and with that of Israel.¹⁰⁴

The establishment of firms that could offer any kind of competition to Israeli producers in the local or Israeli market was restricted rigorously. The expansion of the line of production of existing local firms into the production of items that could compete with Israeli firms became targeted by governmental agencies and in many cases by Israeli firms with the support of the military. Applications for the establishment of firms during this phase, faced increased

¹⁰⁴ This system functioned based on the VAT receipts issued by Israeli or local raw material and machinery suppliers through their transactions with local producers which reflected the amount of raw materials sold for production and the amount of finished goods marketed by the producers. Similar information was collected by customs which reflected the amount of raw materials were imported by each firm. This information is used by Production and Income Tax Departments to estimate the payment due on each individual firm.

difficulty at all governmental department levels. Even the Palestinian run local village or city councils became unable to issue a municipal license for such firms without the acceptance of the Israeli millinery governor and the department of trade and industry.

16- The firm witnessed a series of difficulties with the Israeli authorities, Israeli firms and local town council aimed at preventing the establishment of the firm. In 1984, the firm applied for a production plant permit from the local town council and the Israeli department of interior. This permit was delayed for a few months due to the refusal by both departments to agree to provide the firm with the required electrical power supply for the running of the new factory. The firm selected the lower commercial level of the extended family residence to locate the new production activity which is located on the main road of the town within a mixed use area. The local head of the town council referred the new applicants to the department of interior for obtaining a permit for the provision of the appropriate electrical power for the future plant. The town council stated that they were unable to process the firm's application because it had to do with an industrial plant within a mixed commercial/residential area (The main road of the town had some industrial plants already established that had been approved by the town council. This made the firm insist that the refusal was the result of a policy change by the Israeli authorities). The department of interior on the other hand rejected to deal with the new applicants and insisted that the local town council was in charge of such permits. The firm spent an eight month period between the two departments before they were able to obtain the permit and the appropriate electrical power connections through the local town council.¹⁰⁵

Gaining access to a permit for the establishment of the new firm during this phase however, was not the end of the problems that this firm was likely to face with the various departments of the military government. In many instances, the military authorities have conducted harassment raids on factories during which the owners were threatened and the workers instructed to stop working. The confiscation of the ID card of the owner of a firm is also a technique used frequently by the military authorities. Without this card, inhabitants of the occupied territories will be arrested if stopped by police or military patrol within the territory. Access to Israel is not possible either without the ID card, thus totally restricting the mobility of individuals involved in income generation activities.

17- During the initial year of production, the firm's owners were subject to harassment by the military authorities aimed at forcing them to reconsider their venture and eventually shut the firm down. The military governor of the district was involved personally in exerting pressure on family members to abandon their production activities. The military forces paid the firm many visits, and on many occasions, harassed the workers and confiscated the ID cards of members of the extended family. Without their ID cards, those individuals could not move about the occupied territories or Israel which caused problems for them when attempting to market their production locally or in the West Bank or acquire raw materials from Israel.

¹⁰⁵ This production activity was less restricted during the initial phases of occupation but became increasingly restricted when local producers began developing their competitive edge over Israeli producers in local markets. This prompted competing Israeli firms to place pressure on the Israeli authorities to restrict the development of such production activities.

Israeli firms in competition with local firms chipped in to the system of control over the development of the local economy. On many occasions, those firms obstructed the purchase of second-hand machinery by local firms from Israeli bankrupt or upgrading firms or from machinery auctions. Local firms were unable to make such purchases unless they hired an Israeli agent to make the purchase on their behalf, thus increasing their cost considerably.

7- The new firm was able to locate a set of secondhand textile production machinery which was being sold by an Israeli textiles firm during a process of upgrading. The firm was unable to directly purchase the machinery because of coordinated obstruction by Israeli textile producers who were becoming more determined to limit textile production and competition by Palestinian producers. The firm had to resort to the services of an Israeli middleman to make the purchase on their behalf in order to bypass the concerted effort by Israeli firms to stop this purchase.

Some local producers began facing increased pressure from Israeli firms to abandon the production of goods that compete with their production. Some Israeli firms were able to obtain a court order from the Israeli supreme court, instructing a local firm to terminate its production of a specific product. The court decision could be based solely on the allegation by the competing Israeli firms.

30- There was an Israeli firm producing the same product located in an industrial kibbutz which was not happy with the competition I have begun to represent for them in the Israeli and local markets. On the 2nd of Aug. 1987 I received a court order to appear in Jerusalem for a hearing regarding my factory. The letter stated that a factory producing gas canisters existed in the city of Gaza which was not following all Israeli technical specifications. The letter ordered the closure of this facility until the court decides its future after its session.

32- After receiving that letter, I received a telephone call from the Israeli firm, requesting that I meet with some of its representatives. They suggested that I come to their Kibbutz but I refused and we were able to arrange a meeting in Gaza. They arrived in two cars, a small sedan and a micro bus. You know, I felt that the whole Israeli government was coming. Each had his pistol on his side, walkie-talkies and other equipment. They said that they have arranged to meet in a room in the "Civil Administration" building, but I said I will not meet with you there and that I have a lawyer who has an office close-by where we could meet. At first they rejected the idea but accepted later after making a series of telephone calls over their WT with the military authorities. So we left for the lawyers office where they spread throughout the office with their arms displayed.(p3)

The discussion began and throughout they were trying to convince me to stop producing the gas canisters and offered to give me the cost of all the machinery that I had introduced in that line of production in addition to \$150,000 but I rejected their offers. They then began demanding that I change the size, shape or color of my product which was almost identical to their product in the three areas based on Israeli technical specifications which I followed. I refused their request because I have already invested so much time and effort in developing and perfecting the product and the machinery that I am using to produce it. They kept on insisting that I change the color of my product which was identical to theirs. By the end of our negotiations, I agreed to alter the color slightly. The court-order was dropped after our agreement. A few weeks later, I was shocked to hear from a friend who was fluent in Hebrew, that the Israeli firm had placed a number of ads in the Israeli press, urging the

Israeli consumer not to use the light colored gas canister because it was produced in Gaza, by a Palestinian firm who's intention is to cause harm to their families by marketing a low quality item.

During this phase, Israeli firms and providers of other commercial services increasingly joined the governmental departments in applying pressure on local producers, increasing the limitations on their ability to function and develop. The increased government imposed difficulties for local producers began forcing the balance of control over transactions between Israeli and local firms, in favor of the former. The formal links between local firms and sectors of the Israeli economy became increasingly vulnerable, reducing the level of protection that local producers relied on in their attempt to bypass governmental formal restrictions. These changes have resulted in the movement of some local firms towards the informal track.

As the confrontations between the local firm and the port officials began to mount, because of the intensified security procedures at the port, the firm decided to begin importing all raw materials under the name of an Israeli agent, thus making this agent an important part of the link with the raw material producers. This procedure was adopted in 1984-85 and resulted in a considerable reduction in the problems faced at the port. The drawback to this procedure was that the local firm lost the ability to open its own letter of credit for the required raw materials which is needed in order to obtain a deferred payment plan for the imported goods. The firm also lost access to the deferred payment plan offered by the raw material producer which ranged from 60-90 days after the goods left their port of origin. These payment plans were transferred to the Israeli importers. Their willingness to pass such benefits to the local firm became mostly their decision and not an obligation, leaving the local firm at their mercy. As long as the relationship between the Israeli agent and the Palestinian firm was smooth, the firm faced few problems with this arrangement. But when relations began to deteriorate during the 80s and worsened during the years of the uprising, the link became increasingly vulnerable and Israeli agents began refusing to extend any of the benefits they received from the external raw material producers.

The access of informal local firms to the Israeli economy became more restricted, forcing some to limit their links to the local economy and suspend their relations with the Israeli formal and informal economies avoiding all relations and activities that could expose their economic transactions to the authorities. The confinement of their activities and relations to the local economy introduced a number of limitations on those firms. Their access to the main sources of appropriate supplies of raw materials and machinery as well as their link to a wider range of technology transfer sources and their access to their traditional niches in the markets of the West Bank and Israel was mostly lost.

In 1985, two years prior to the start of the uprising, the authorities introduced the production tax on all producers in the occupied territories. This step created a difficulty for local producers in avoiding payment of the new tax if they attempted to channel their products

through the border, to the markets of the West Bank or Israel. Border check points were employed to monitor the movement of goods leaving the territories. The production tax estimates were based on receipts issued by the Israeli suppliers of raw materials and equipment which the local producers dealt with. Most firms in this area of production used to falsify receipts in order to bypass production tax payments. This firm was uncovered by the authorities a few months prior to the uprising and was forced to pay \$30,000 to make up for past due payments. This resulted in the shrinking of this firm's scope of production. This incident opened the door for the authorities to begin collecting production tax estimates on quantities produced by the firm during the years prior to the official introduction of the tax law.

In December of 1987, the uprising erupted in the occupied territories bringing with it an escalation in disturbances and a conscious attempt by the population to reduce the relationship of restrictive dependency that had evolved between the local economies and that of Israel. The concept behind the new movement was multifaceted, and included as a main goal the reduction in the general rate of consumption by the local Palestinian population and the boycott of Israeli products that could be produced locally. The population was urged to support local production and to promote self-reliance through the establishment of household production activities that could be sufficient for meeting the basic nutritional needs of the local population. The daily working hours for all retail activities were reduced by order from the Palestinian leadership to three hours (9:00 am - 12:00 pm), in an attempt to cut down on consumption. However, certain production activities were allowed to function 24 hours a day including strike days.¹⁰⁶ The Palestinian labor force employed in Israel (now 50% of the total Palestinian labor force) was also instructed to reduce its reliance on Israeli jobs and to attempt to find local employment or independent income generation alternatives.¹⁰⁷

The Israeli authorities responded with an unprecedented escalation of individualized surveillance practices of all economic transactions within the two territories through border surveillance and raids on local economic activities. The Israeli military authorities in coordination with the tax departments began issuing "Magnetic ID cards" to all individuals from the Gaza Strip involved in production, retail or direct employment in Israel or within the territory. Those IDs are used to expose the tax payment status of the holder at all border crossings and were used to force the formalization of all income generation activities with links to the Israeli economy and which therefore required crossing the border. Firms requesting travel permits that would allow them mobility between the two territories had to expose even

¹⁰⁶ Local firms with subcontracting links to Israel were instructed to abide by the general strikes.

¹⁰⁷ All such workers were also required to abide by the general strikes.

more of their economic activities in order to fulfill all the requirements for the issuance of such a permit.¹⁰⁸ Very few firms were able to maintain the ability and the willingness to request such permits.

- The ability of a firm or individual to gain access to the West Bank depends on their ability to obtain a travel permit from the Israeli Civil Administration and Trade and Industry departments. The issuance of this permit is linked to the ability of the firm or individual to obtain clearance forms from various governmental departments (Taxation, Police, Municipality and in the case of this firm, from the Health departments, because of the nature of its product). The permit is valid for a period of 1-3 months and is subject to cancellation at the discretion of a border official. The same procedure is required for its renewal .

Frequent taxation raids and stringent taxation collection procedures were employed to force all firms with links to the local economy to formalize their activities. The new tax estimates were increased considerably and became increasingly unrelated to the actual performance of the particular activities, but based on the wishes of the collection departments. Collection raids backed by the military, were conducted on the homes of income earners during Israeli imposed curfews.

1- During the uprising, the taxation authorities with the aid of other governmental and military authorities, have intensified the level of surveillance over the individual economic activities of local producers and retailers at both macro and micro levels. Firms and retail shops are now subject to frequent taxation collection raids during all phases of production, delivery and sale of their products, through direct taxation raids on the factory or shop, stoppage, inspection and confiscation of delivery trucks while making internal or external deliveries and compulsory audits of the firm's accounts at various periods of a calendar year. The mobility of the firm's members and their ability to maintain uninterrupted inter-regional links to markets and supplies of raw materials and technology transfer, has been linked to their tax payment status.

The taxation and customs departments enhanced further their system of communications, pushing local producers further away from their needed formal links. It became very difficult for local firms to maintain links with formal sources of raw materials, machinery or access to formal retailers without totally exposing their activities to one or more of the tax departments.

4- The income tax department has been basing its estimates of anticipated profit likely to be generated by local firms based upon information furnished by customs, production and Value Added Tax departments indicating the size of raw material purchases and sales that the firm has been making during a calendar year. The income tax department has increased its estimates of the anticipated rate of profit that a firm is likely to make from 10% to 15% per year, an increase of 5% during the three initial years of the uprising. This increase has occurred even though profits and the size of production have been decreasing for most local firms .

¹⁰⁸ The bureaucratic procedures required to obtain these permits became increasingly complicated, requiring the presence of the applicant for the duration of the process.

The strikes called for by the Unified Underground Leadership of the Uprising and the curfews imposed by the authorities in response to the escalation in disturbances, in addition to the increased border restrictions and the escalation of punitive economic measures on the population, resulted in the disruption of all economic activities in the territories and between them and the Israeli economy, and caused an immediate decline in the average income of the local population and significant changes in the character of the local industrial sector.

During this phase, firms that were able to develop sufficient links to local demand were able to succeed and in some cases expand their production because of the decline in competition with Israeli and imported goods. Access to a sizable local demand and some continued access to Israeli markets allowed some of those firms to afford maintaining formal links with Israeli formal sectors, despite the increased practices and restrictions.¹⁰⁹ Those firms had to remain formal and could not afford losing such links and thus become restricted to the limited sectors of the local economy. The stability of their access to a niche in the local market became very significant in providing them with the financial support and the continued availability of working capital, while their ability to gain access to Israeli consumption enforced their position further.

Other firms were able to guarantee some local demand for their products but it was not sufficient to allow them to maintain a fully formal operation. Those firms tried to keep open their formal access to raw materials but were not able to afford to maintain other formal links. Even their access to raw materials shifted towards the informal, if sufficient supplies and good prices were offered by the informal local sources.

Firms with subcontracting links with Israeli firms continued their relations, but on the whole, experienced declines in their rates of production because of the decline in the sale of their finished products through the parent Israeli firms in local markets. They were thus forced to increase the number of Israeli firms that they subcontracted for, in an attempt to make up for the loss of business from their original suppliers, or were forced to redirect their production toward the production of finished goods for local demand. The success rate among redirecting subcontracting firms has been very low because of the decline in local demand for their specific products, or their lack of knowledge about the characteristics of the local markets and dealing

¹⁰⁹ particularly, Palestinian population demand in those markets.

with its various sectors.¹¹⁰

However, many local firms during this phase have tried to maintain a level of subsistence so as not to lose their links with the labor force they have invested in training and with other sectors of the local economy, in the hope that conditions would improve in the near future. Many of those firms capitalized on their flexibility and began moving into branch production or income generation activities, to balance their losses in their main production lines.

29- This firm felt that the production activity was not profitable during the years of the uprising. The firm continues with it in order to stay in the market until the conditions in the territories improve. The main source of income for the firm has been through the maintenance activities which could be conducted away from taxation collection. The income generated from the production activities have been covering the cost of the labor force, materials, rent and other related expenses, but have not been sufficient to cover living expenses for the firm's owner and his extended family.

4.3 STRUCTURE OF CONTROL: Restrictive Regulations & Practices.

During the initial phases of occupation, firms within specific areas of production faced minimal resistance from the Israeli authorities in obtaining their registration requirements.¹¹¹ The Israeli authorities had, on a few occasions in fact encouraged local entrepreneurs to establish businesses as long as they were not in competition with Israeli producers for local or Israeli markets, and were engaged in activities that were complementary to the production activities of Israeli firms. However, local production activities that posed a competitive potential for Israeli firms were formally obstructed.

10- The factory was registered as a production plant from the outset and registered for the payment of production tax on all its production. The firm obtained a license from the Municipality of Gaza and the Israeli Department of Trade and Industry. The firm faced no problems in obtaining the license from either authority. That was in the early 1970's.

The ability of the Israeli authorities to control the development of the local productive sectors through formal, macro-level policies proved to be relatively unsuccessful. This realization led to a dramatic shift in policy in later years. The goal of the initial policy was to

¹¹⁰ These types of firms had previously relied fully on the Israeli parent firms for the marketing of the finished goods and acquisition of raw materials. Their direct relationship with local retailers was not developed and their ability to forge links with suppliers of raw materials proved to be limited. The rigidity of their production activities and their specialization limited their ability to alter lines of production to suit local demand.

¹¹¹ These firms were usually involved in production activities that offered services for Israeli producers or were not in direct competition with Israeli firms.

accelerate the process of linkage between the two economies and the creation of a pattern of productive sector development in the territories that was subservient to the Israeli economy and its requirements. During the initial phase of occupation, prior to the intensification of surveillance procedures by the departments of the military administration, many formal and informal production firms began to appear in subsectors that later came under severe Israeli restrictions. The appearance of such firms and their effective competition with Israeli producers despite a wide range of restrictive policies and a lack of incentives and required services, led to a clear intensification of restrictions at all levels and applicable to all productive sectors of the Palestinian economy.

Local firms that provided the Israeli economy or firms with useful services and had developed extensive links with it, gained some measure of protection against the actions of the departments of the military authorities.¹¹² However, this protection was ineffective in areas in which local firms had to function independent of their Israeli protectors. Even though some local firms have maintained a formal and, to a certain extent, protected status with the taxation authorities and consequently with the departments of the military government, their status was immediately undermined once they had to rely on local informal or unprotected links for any portion of their economic activities. This point could be demonstrated well through the experience of a group of local subcontractors that enjoy stable links with Israeli firms:

20- A number of local firms with subcontracting links to Israeli firms have been jointly hiring a local truck for the delivery and pickup of materials and finished goods between themselves and the Israeli firms. Even though most of the involved firms have a clean record with the taxation authorities, and stable links with Israeli firms, their goods are usually impounded by the border authorities until the truck driver makes a certain payment to cover new estimates on his economic activities by the taxation authorities. In such cases, the firms are forced to jointly make the due payment on behalf of the trucker, in order to keep the flow of their goods uninterrupted. These payments represent a considerable additional cost to the subcontracting branch of the firm.

During that initial phase of occupation, many local firms in restricted subsectors avoided the confrontations with the authorities by maintaining a considerable segment of their transactions as informal, thus reducing their exposure to government departments or formal sectors of the economy. Most of these small informal producers limited their registration procedures to local municipal departments which were run by local Palestinian bureaucrats, and headed by Palestinian mayors. They also registered their operations as assembly or

¹¹² These are firms that were engaged in direct subcontracting relations with Israeli firms.

maintenance activities rather than production operations, in order to avoid any links with the production tax departments. Very few have attempted to register their operations with the Department of Trade and Industry which is controlled by the military government, in order to avoid linking themselves to the Israeli taxation system and becoming subject to formal restrictions, unless they were unable to function without links to formal Israeli or imported sources of raw materials, machinery and technical transfer and an access to Israeli markets.

23- The initial maintenance shop obtained a municipality license for operation as a maintenance activity. When production began in 1985 and maintenance became a side operation, no additional license such as a factory permit was obtained in order to avoid bureaucratic requirements such as: specifications testing requirement, opening a new file for the collection of production tax..... Instead, the firm acquired a license for the renovation of electrical appliances. This enabled it to avoid the production tax and other specification testing requirements.

At the initial stages, most of the links that the informal firms had with other local or Israeli producers and consumers were informal, avoiding the issuance of formal receipts which would link them to the VAT and income tax departments. Most acquired their raw materials and production equipment through informal, local or Israeli raw material merchants rather than importing those goods directly or through formal Israeli import agents. For the most part, they relied on secondhand machinery that they acquired from machinery dealers or directly from upgrading or bankrupt firms. Most of their transactions were in cash in an attempt to avoid detection through the use of bank checks by the tax officials who have free access to all local bank records.

During the early 1980s, the registration requirements became more rigid and most such firms were forced to become formally registered with the Department of Trade and Industry and began paying a 30%-35% production tax. The inability of all local firms to gain direct access to export markets has prevented them from reclaiming their production tax payments which are refundable after export. The sudden introduction of this tax resulted in pressure on local producers to increase their sale prices in order to cover this additional expense. Many local consumers and retailers refused to pay this sudden increase, forcing local producers to absorb some of the added cost and reduce their profit.

The forced registration of local firms with the production tax department automatically linked their records with the income tax and VAT tax departments. Their economic activities became more closely monitored through border inspections on the way to Israeli markets, or

through their formal Israeli suppliers of raw materials, and through periodic taxation raids on their workshops.

24- Just before the uprising, we were forced to register the firm as a production firm and we began paying production tax of 30% of the cost of production. We tried bypassing this problem and avoid paying this tax by suggesting to the taxation authorities that we were using secondhand parts for the reassembly of the washer and we also attempted to reduce the size of the basin from 5 kg to 3 kg in order to reduce the tax we had to pay. All our attempts failed and they forced us to abide by those rates.

There were many obstacles to the establishment of new firms during the late 1970's and early 1980's in areas of production that were unrestricted in the early years of occupation. The expansion of existing lines of production and the introduction of new products became increasingly difficult. Firms began facing difficulties with competing Israeli firms who feared the competition with new entering producers from the occupied territories. These Israeli firms were concerned about losing their access to the markets of the occupied territories. So they concentrated on blocking the sale of used machinery to local producers. However, they were unable to block the purchase of new machinery by those local firms.

During the same period (late 1970's and early 1980's), local firms began facing difficulties in obtaining operating permits from the Civil Administration's Department of Trade and Industry. They also began facing difficulties in obtaining the required permits from the local city or village councils which had come under the total control of the Israeli military and civil authorities. The experience of a textiles manufacturing firm illustrates the various levels of bureaucratic obstacles that a new firm could face in obtaining the required permits in the early or mid 1980's:

16- The firm witnessed a series of difficulties with the Israeli authorities, Israeli firms and the local town council, aimed at preventing the establishment of the firm. In 1984, the firm applied for a production plant permit from the local town council and the Israeli department of interior. This permit was delayed for a few months due to the refused by both departments to agree to provide the firm with the required electrical power supply for the running of the new factory. The firm selected the lower commercial level of the extended family residence to locate the new production activity, replacing the exhibit space which was used as a show room for the used car business located on the main road of the town within a mixed-use area. The local head of the town council referred the new applicants to the department of interior for obtaining a permit for the provision of the appropriate electrical power for the future plant. The town council stated that they were unable to process the firm's application because it had to do with an industrial plant within a mixed commercial/residential area (The main road of the town had some industrial plants already established that have been approved by the town council which made the firm insist that the rejection was the result of a policy change by the Israeli authorities). The department of interior on the other hand refused to deal with the new applicants and insisted that the local town council was in charge of such permits. The firm

spent an eight month period between the two departments before they were able to obtain the permit and the appropriate electrical power connections through the local town council .

Another source of harassment to newly established or existing firms during that phase, came from the military authorities who became active in opposing or discouraging the production activity during or after its establishment. Military patrols were used to harass the owners and the workers of certain firms. On many occasions the officers in charge confiscated the owner's I.D which could effectively limit the individual's mobility within and between territories.

17- During the initial year of production, the firm's owners experienced harassment by the military authorities aimed at forcing them to reconsider and eventually shut the firm down. The military governor of the Beit Lahia district was involved personally in exerting pressure on family members to abandon their production activities. The military forces paid the firm many visits, and on many occasions, harassed the workers and confiscated the I.D cards of members of the extended family. Without their I.D cards, those individuals could not move about the occupied territories or Israel which caused problems for them when attempting to market their production locally or in the West Bank or acquire raw materials from Israel .

Israeli firms which found themselves in direct competition with local producers have been able to gain the support of the various central and local governmental departments in obstructing the activities of those local firms. The Israeli Supreme court has issued orders for the closure of such local firms based on requests and evidence provided by Israeli competitors. All court orders and instructions that are sent to local firms have been in Hebrew which is not formally understood by the inhabitants of the territories.

30- An Israeli firm producing the same product which is owned and operated by an Israeli industrial kibbutz became uncomfortable with the competition I have began to represent for them in the Israeli and local markets. In Aug. 1987 I received a court order to appear in Jerusalem for a hearing regarding my factory. The letter stated that a factory producing gas canisters existed in the city of Gaza which was not following all Israeli technical specifications. The letter ordered the closure of this facility until the court decides its future after its session. I really didn't understand the letter. I don't read Hebrew, and I didn't give it much attention at the beginning, but I was then contacted by representatives of the Israeli producers who informed me of its content.

The Israeli military authorities provide those Israeli firms with the required protection during intimidation visits and negotiation sessions with local firms.

"I met the representatives of the Israeli firm on Thursday morning at 7:30 am. They arrived in two cars, a small sedan and a micro bus. You know, I felt that the whole government was there, each had his pistol on his side, wireless telephones and other equipment".

The military authorities are usually willing to conduct independent intimidation visits to local firms after they are aware of a conflict. In many cases, the local branches of the Israeli tax departments have increased their harassment and audits of these firms during the period of negotiations between the competing Israeli and local firms. In some cases, local firms have faced increased bureaucratic obstacles from local municipal departments rejecting expansion permits or power connection requests.

35- The problem with the municipality escalated at the same time that I began having problems with the Israeli Kibbutz. I feel that the two were related. The municipality disconnected my electric supply at numerous occasions during the last three years at the Sabra location, disrupting production and causing me considerable losses.

Some local firms have faced difficulties in obtaining certification for their products from the Israeli Technical Institute (Technion), which is required for the formal sale of industrial products in the markets of Israel and the territories. The products of local producers are usually rejected and failed by the officials conducting the tests. Usually, no explanation is provided with test results that could identify the causes behind the failure of the local products, leaving local firms with no clear direction upon which to conduct modifications on their products. All the specifications and test procedures are published only in Hebrew, making it extremely difficult for local producers to understand and abide by the regulations.

45- All the correspondence, reports, test procedures and results of testing by the Technion are provided in Hebrew only. Very few local producers have mastered the Hebrew language sufficiently to benefit from these reports, or even understand the requirements and the deadlines. We always have to resort to a translator to help us understand those instructions, and such help is usually not professional help. I have purchased a booklet that they issue which is also in Hebrew, that gives instructions on the test procedures and the recommended outcomes. I had the book translated, and tried to go by those instructions regarding the type of raw material I use, the design of the tube and the production procedure that guarantees the ideal results.

THE ADVENT OF THE UPRISING:

During the years of the uprising, the hostile macro level policy restricting local economic activities and the surveillance apparatus it employs has been duplicated at the micro level. Income generation activities of all types and scales and their related activities have been targeted closely through a system of close surveillance and increased restrictive bureaucratic procedures. The level of exposure and thus vulnerability of those economic activities has been drastically increased while leaving them limited recourse to legal protection against the newly

introduced or more harshly implemented policies. The attempts by local firms to gain formal or informal protection for their economic activities has been gradually failing. Firms' activities are becoming vulnerable to the scrutiny and unjust harassment by the officials of the various Israeli governmental departments at all levels.

1- During the uprising, the taxation authorities with the aid of other governmental and military authorities, have intensified the level of surveillance over the individual economic activities of local producers and retailers at both macro and micro levels. Firms and retail shops are now subject to frequent taxation collection raids during all phases of production, delivery and sale of their products, through direct taxation raids on the factory or shop, stoppage, inspection and confiscation of delivery trucks while making internal or external deliveries and compulsory audits of the firm's accounts at various periods of a calendar year. The mobility of the firm's members and their ability to maintain uninterrupted inter-regional links to markets and supplies of raw materials and technical transfer, has been linked to their tax payment records.

The intensification of tax collection procedures and the absence of legal tax estimation techniques have resulted in a drastic increase in the amounts of tax payments collected from local firms. The increases have not been based on the actual size of economic activities and have thus not taken into consideration the drop in the average size of production for a large percentage of local firms during the years of the uprising. They have instead relied on production levels from years prior to the uprising to use as a base for the estimation of current tax payments. This also has driven many of the local firms towards avoiding registry with the taxation authorities and suspending their links with all formal, local or Israeli sectors.

2- The increase in the taxation rates during the uprising has been much lower than the actual increase in the amounts collected from firms during this same period if compared with amounts collected before the uprising. In most cases, the newly introduced tax estimation and collection procedures have at least doubled the amounts of taxes collected from local firms and retailers .

The network of surveillance links between the taxation and customs departments was further enhanced. The income tax department was added to this network, and began obtaining its information about the economic activities of the local firms and individuals involved in income generation activities. The income tax department has based its estimates on the assumption that the scale of production at each firm has been increasing during the uprising and thus ignoring the actual decline in production for most local firms due to the economic slow down of the past few years.

4- The income tax department has been basing its estimates of anticipated profit likely to be generated by local firms by relying on information furnished by customs, production and

Value Added Tax departments indicating the size of raw material purchases the firm has been making during a calendar year. The income tax department has increased its estimates of the anticipated rate of profit that a firm is likely to make from 10% to 15% per year, an increase of 5% during the three initial years of the uprising, even though, profits and the size of production has been decreasing for most firms.

The collection and estimation of income tax dues for local firms has represented a major obstacle for the functioning of most local firms. At the beginning of each calendar year, local firms are issued a set of income tax coupon booklets. These coupons represent estimates made by the income tax department based on the economic activities of the firm during the previous year. Those estimates are always based on the assumption that the firm will increase its volume of production and profits during the new year. Once the coupon booklets are received, the firm's owners try, through negotiations with the tax department officials, to reduce these estimates to a level comparable with their anticipated sales. In most cases, the firms succeed in reducing the amount of payments and are thus issued new coupons reflecting the adjustments. Even though an agreement has been reached, the income tax department never adjusts the original estimate on a firm's record in the main computer terminal.

The unwillingness by the central department to change the computer records, presents local firms with their main source of problems during that calendar year. Whenever a firm's truck or any of its partners are stopped by taxation officials at a border crossing or within the Strip, the official's computer record will reflect the original tax payment estimate and will thus show a discrepancy between what the firm has been paying and what it actually owes according to the original unchanged estimates. This situation will always result in the immediate grounding of the truckload or the confiscation of the partner's I.D card until payment of the balance is made, in addition to a fine and a daily grounding fee for the truck (usually \$30 per day). The border official seldom accepts the adjusted tax payment agreement, even if the firm presents the newly issued coupon booklet. Both the initial negotiation process and the frequent taxation inspection incidents are extremely time consuming for the partner involved, resulting in the disruption of production and sale activities for a considerable period of time ranging from 3 to 4 weeks every year. The same negotiation process is often repeated at the end of each year in an attempt by the firm's owners to remind the taxation officials of the initial agreement they had reached with them to reduce the taxation payments and also to show that the actual economic activities of the firm during the past years have been below the

department's estimates. However, most appeals by local firms at this phase are denied and in most cases a firm ends up having to pay more than it legally owes. As long as local firms are unable to get a guaranteed commitment from the tax authorities on the outcome of the negotiations and a permanent adjustment on their computer records, firms will always be faced with changes in the estimates by the various tax officials during the calendar year.

Unlike the situation with Israeli firms, local producers and retailers have to conduct all their transactions with the authorities in person and can not communicate with those authorities through the mail or through their accountants. These processes have been very time consuming and humiliating for other firms' owners, requiring them to wait in long lines usually stretching into the streets surrounding the tax department offices. The process has been very slow, requiring the return during the next day, of the individuals that have not reached the window by the end of the work day which usually ends at 2:00 pm. The most agonizing aspect of this process is that the outcome of the negotiations at the end of the long wait will seldom mean the end of this procedure for that calendar year and that the same procedures could be repeated at many occasions during that same year as a result of the haphazard incidents of harassment and audits by the taxation officials.

7- At least one of the partners of the firm has to be present in person for all communications with taxation department officials. Unlike Israeli firms, this local firm could not communicate through the mail at any phase of the tax filing or negotiations process, and ends up having to wait in long lines for any type of consultation or communication with the taxation officials.

During the years of the uprising, the production tax estimates have been based on the assumption that local firms produce no waste during their production process, delivery of finished goods or the transport of raw materials. The amount of raw material damaged during production or finished goods damaged during delivery are never acknowledged and local firms are forced to make payments based on the unrealistic assumption that they have processed 100% of the raw materials they have purchased. This has placed more pressure on local firms to look for informal sources of raw materials so that the authorities will not uncover the actual amount they have acquired. Most local firms have not been successful at deducting their business related expenses from their income tax dues. The majority have felt that once they claim reimbursement on those expenses from the income tax department, they are in fact exposing their economic activities further and thus opening the door for increased estimates by

the taxation department, which will assume that the reported expenses reflect taxable growth of the production operation.

Local firms make the 16% VAT tax payment on all purchases from or through Israeli suppliers of raw materials, machinery and services and are supposed to recover such payments from their customers after the sale of the finished goods. The uncollected payments should be refunded by the VAT department. Unlike Israeli firms and retailers, local firms have faced great difficulties in collecting any refunds for unrecovered VAT payments from the VAT department. Any persistence by firms for reimbursement could result in an audit of their accounts resulting in most cases in additional fees and tax payments, and further exposing the firm's economic activities to other tax departments. This outcome made most firms avoid filing for any reimbursements, no matter how confident they were about the accuracy of their account books.

Recovering the value added tax has been very difficult. If we try to recover any of the amount that we have over-paid, they catch us for other things. We never come out of their offices with anything in our pockets. So we avoid to mention any of the amounts they owe us”.

5- Unlike Israeli firms, this firm is unable to deduct any job related expenses from the amount of income tax paid in an attempt by the firm to avoid additional exposure to further scrutiny of their economic activities.

During the years of the uprising, the magnetic I.D card was issued to all income earning adults in the Gaza Strip, in an attempt by the authorities to link all income-generation activities (including employment in Israel, local professions, production and retail) to the Israeli taxation departments. This card is valid for a six month period, and can only be obtained or renewed if the recipient has completed the payment of all tax dues and payments for municipal services. This card is requested by army and taxation officials at all border crossings before any individual is granted free passage to Israel or East Jerusalem. This enables those officials to retrieve the card holder's tax payment record on their computer terminal at the border check-point, determining whether or not an individual could exit the Strip.

The introduction of the magnetic ID at the beginning of the uprising, expanded the surveillance system by the tax and other governmental departments to include the ability to retrieve the record of any individual even if they were not involved in production, transportation or sale of produced goods when they are stopped for inspection. Linking the ability to enter Israel with validity of this card, forcefully connected the informal Palestinian labor force employed in Israel with the various tax departments. No worker could gain access

through the border unless they present a valid magnetic ID reflecting constant monthly payments to the various departments.

In addition to the magnetic ID which is required for the crossing of the border into Israel, another permit is required for the entry into the West Bank. The difficulty faced in obtaining this permit has resulted in the gradual decline in the size of economic and social relations between the two territories while links between Israel and the two territories are less restricted.¹¹³ This has resulted in the confinement of local producers to the markets of the territory that they are located in and has thus brought about a repetitive pattern of development in both territories instead of a complementary one. The majority of local producers who had access to the markets of the two territories prior to the uprising were forced to reduce their scale of production to a level sufficient for the local consumption of the territory in which they reside. This also resulted in the development of new firms or the growth of other existing ones in each territory in attempts to fill the gap left by the disruption of product flow.

- The ability of a firm or individual to gain access to the West Bank or from the West Bank to Gaza, depends on their ability to obtain a travel permit from the Israeli Civil Administration and Trade and Industry departments. The issuance of this permit is linked to the ability of the firm or individual to obtain clearance forms from various governmental departments (Taxation, Police, Municipality and Health departments). The permit is valid for a period of 1-3 months and the same repeat procedure is required for its renewal .

The inability of Gaza producers to gain access to the West Bank has been especially devastating. The size and the diversity of the Gaza market is very limited compared to that of the West Bank. The presence of East Jerusalem as a cosmopolitan center in the middle of the West Bank provided that territory with more extensive links to foreign and local non-governmental aid groups located in that city. The barriers faced by the West Bank population and the unwillingness of the Jerusalem inhabitants and the members of its relief groups to make the inconvenient trip to the Gaza area, resulted in the gradual isolation of the Strip from the opportunities offered by such groups.¹¹⁴

As a result of these increased pressures during the years of the uprising, many local firms have been increasingly transforming segments of their functioning systems from formal

¹¹³ This has been done to further confine local producers to the markets of their territory and increase their reliance on Israel. This step was also taken to prevent the coordination of activities between the populations of the two territories.

¹¹⁴ The Gaza Strip, unlike the West Bank, has only two strictly monitored border crossings. The small size of the Strip and the more frequent occurrence of activities against the Israeli occupation has made the Strip a place to avoid for many visiting aid and humanitarian groups even though it is the more needy of their services.

to informal. However, some firms with relatively modern production processes and larger scale production activities have not been able to do so and thus have maintained formal links with the Israeli suppliers of raw materials, machinery and other essential services. Those formal links automatically expose their economic activities to the various taxation departments. All they can do is keep accurate records in order to challenge the taxation authorities on factual basis. Nevertheless, many of those firms have transformed a segment of their activities from formal to informal, particularly in areas that are under less surveillance by the authorities.

15- The allegations that producers in the territories do not keep accurate books and avoid formal channels in an attempt at bypassing taxation inspection are only applicable to small and informal firms who can't afford but to do so under those restrictive conditions. Larger formal firms such as this one could not afford to abandon its formal status because of its formal links to Israeli retailers and suppliers of raw materials who are used by the taxation authorities as proof of the scale of the local firm's economic activities. Unlike the smaller informal firms, this type of local formal firm could not abandon such links and rely on local informal links to replace them due to the limited local capabilities and the scarcity of the required services.

The more informal a local firm becomes, the more it will be confined to local markets and the limited local ability for the provision of required services. Local firms have thus based their decision on their ability to find sufficient demand within the local markets as well as a sufficient informal supply of raw materials and machinery and technical assistance. The limitations of the local sectors have resulted in the decline in the level of technical advancement, quality and scale of production of many local firms. However, some local firms have been able to grow because of the increase in demand for their products due to the decline in the consumption of Israeli produced or imported goods.

Firms that have decided to confine their links to local markets, informal local and Israeli suppliers of raw material, machinery and technology transfer, have also been very cautious about publicly exhibiting their products. This basic metal products firm has been forced to disconnect itself from all promotional public events out of fear of exposure to the authorities:

26- We currently avoid advertising our products in any public media or in exhibitions in an attempt to avoid attracting the attention of the taxation officials. We used to present our products in exhibits for Palestinian production to encourage demand from West Bank and Israel's Palestinian population who do not know about our product. We can't do that anymore. The authorities have used such events for discovering new production activities and to evaluate the success of existing producers.

Those firms are also very cautious about who they deal with especially among Israeli retailers. They will usually make an effort to reduce their exposure to their Israeli competitors

who are suspected of providing the Israeli authorities with information regarding the scale of economic activities of local firms in the Israeli markets.

27- The Israeli taxation authorities rely to a great extent on informers who supply them with accounts of the firm's economic activities. In some cases, Israeli producers of similar products who feel that they are in competition with our products with Palestinians residing in Israel or in local markets could inform the taxation officials that such and such a firm has a lot of sales in this region. Therefore, if our books do not reflect the reported activities, they will automatically require payment according to what they estimate the profit could have been.

4.4 PATTERNS OF PRODUCTION PROCESSES:

Surviving Production Activities:

The majority of manufacturing firms that survived the transition from Egyptian to Israeli control in the Gaza Strip employed traditional techniques such as the production of pottery or rug weaving, or outdated production processes with workshops producing a variety of low quality products for local consumption. Very few firms utilized modern machinery and were able to maintain links with modern sector suppliers of machinery or raw materials outside the Strip.

TRADITIONAL PRODUCTION ACTIVITIES:

The producers of the traditional goods lost most of the local demand for their products because of the influx of low-quality, low-cost, mass produced Israeli goods into their local markets. However, these producers found a new and sizable market for their traditional products in Israel both for local consumption and export. During this initial phase, the producers of traditional rugs, wicker furniture and pottery experienced growth and maintained their traditional production processes, establishing extensive subcontracting relations with Israeli retailers and exporters.¹¹⁵

SMALL-SCALE WORKSHOP PRODUCTION:

Small-scale production activities faced a great deal of competition from mass-produced,

¹¹⁵ This shift from targeting local demand to relying on Israeli retailers and exporters made these producers very vulnerable to any shifts in the new pattern of relations with the Israeli retailers. This vulnerability became evident during the later years of the occupation when consumption of such goods in the Israeli and export markets declined. By that point, the products had been altered to an extent that they became unsuitable for local consumption.

low-cost goods that invaded the local market from Israeli sources. These local producers were forced to target small segments of local demand that continued to consume their products and services on an individual small-scale bases. However, some of these producers were able to grow during this phase if they were able to provide good quality products or services to their individual customers that rivaled or was on the same level of quality as Israeli goods and at a lower price. Some of these small-scale specialized production activities began to prosper as the average income of the local population began to rise through employment in Israel or in the surrounding Arab region.

Firms engaged in these types of production activities limited their marketing links to local markets, but were gradually able to establish links to Israeli sources of machinery, raw materials and informal sources of technology transfer. Their production processes remained labor-intensive, usually utilizing second-hand machinery obtained from Israeli second-hand machinery auctions or from local sources. The small size of the local market for the products of such firms and the increasing competition between those firms, forced most to remain flexible and maintain the ability to alter their production according to changes in local demand.

MODERN SECTOR PRODUCTION ACTIVITIES:

Firms of this type were already utilizing fairly modern machinery and production processes and producing higher quality consumer goods when the Strip fell under occupation in 1967. Many had stable niches in the local market which continued to exist during the transitional phase. The demand for the products of these firms during the initial phases of occupation helped some to establish new links with Israeli suppliers of raw materials and machinery or enforce their prior links with external sources.

The connections that some of these firms had already established with external modern sector suppliers of machinery and raw materials provided them with the required edge to compete effectively with Israeli producers in local markets. Some firms were able to develop their production activities and capitalize on their lower cost of production and higher quality of products to compete with Israeli producers in Israeli markets as well.

These production activities were larger in scale, utilized mass-production processes and were mainly specialized in the production of specific items such as cosmetics, plastic products, soft drinks and cigarettes. The ability of these firms to maintain stable sources of demand for

their products in local markets and eventually Israeli markets, helped them maintain the same areas of production and not become forced to diversify their production activities and production lines.

Subcontracting:

Subcontracting relations began to evolve immediately after the occupation of the Gaza Strip and the West Bank in 1967. Israeli clothing producers in particular began making relationships with local sewing workshops in order to capitalize on the cheap local labor supply in the territories and to thus become able to gain access to local, Israeli and export markets. In the initial phases of these relationships, local sewing workshops experimented with low-cost, second-hand machinery but began to use a new assembly-line system of production which was quite different from the familiar individualized tailoring operations.

The details of the new system were acquired through the Israeli parent firms and required the specialization of the workers in specific tasks rather than the familiarity of each worker with the entire operation. The skill level and knowledge by the workers of the general profession of tailoring became less significant. These subcontractors employed workers with a wide range of backgrounds with no significant prior experience with sewing operations.

Most of those production processes developed very limited links with other local production firms or maintenance workshops. Most of the required external services were acquired through the Israeli parent firms or other Israeli sectors. However, these firms always aimed at reducing their reliance on external local or Israeli firms for the provision of required services and aspired to develop comprehensive in-house capabilities. Most of these firms were specialized in the production of specific clothing items, and were unwilling to diversify their lines of production in order to maintain the simplicity of their production activity and to safeguard the quality of their products.

During the years of the uprising, many of these firms were forced to redirect their lines of production and begin producing finished goods for sale in the local markets as a result of the loss of easy access to subcontracting relationships with Israeli firms and the increased difficulties with the taxation departments. During this phase, the drawbacks of specialization and the nature of the subcontracting relationships began to emerge. The reliance of those firms on the Israeli firms for marketing and acquiring raw materials left them with very limited contacts or knowledge in those two areas. The rigidity of their production activity and their

inability to produce a variety of items made it increasingly difficult for them to respond to the changes in local demand and to the limited local consumption of the specific items they produced.

Producers of Low Quality Consumer Durables:

This type of production activity evolved during the second phase of occupation and was initiated by local workers who had returned from their Israeli jobs, after having gained some production ideas and having established marketing contacts in Israel. The nature of Israeli firms that these local workers were employed with was very similar to the firms that they established locally, at a later stage. Most were based on labor-intensive production processes, low fixed capital investments and the use of second-hand machinery for the production of lower quality durable goods such as commercial refrigerators, gas stoves and electric heaters. The products were mainly targeted towards low-income groups in Israel or the commercial sectors in the Israeli economy, such as restaurants and produce or meat markets.

8- The initial fixed capital was 15,000 J.D. (Jordanian Dinars). The amount of working capital required, was usually double that. We have not added much to the amount of initial fixed capital by introducing new machinery since the beginning of production.

Local producers gained a competitive edge over their Israeli counterparts because of the lower cost of labor.¹¹⁶ The reliance on secondhand machinery and the use of labor-intensive production methods helped maintain the rate of fixed capital investment at a minimum, and guaranteed a competitive edge over Israeli producers. Producers were able to capitalize on the contacts they made in Israel during their period of employment, to sources of raw materials, second-hand machinery and other Israeli production activities. Through these contacts, they were able gain sufficient knowledge about the production activity, suitable sources of raw materials and machinery and retailers in the Israeli market.

These firms began establishing their own subcontracting system with small local producers. The local subcontractors provided these firms with items that went into the assembly of their product such as shelves, handles and door joints for commercial refrigerators, or brass heads and plastic components for gas stoves. These firms did not establish significant links with the local consumption. Most of their products were sold in

¹¹⁶ Wages of Palestinian workers in Israel remained higher than their wages in the territories until 1983. After that year, local wages became 13% higher than wages earned in Israel. Al-Dweik, "Self Selection," 150.

Israel.

When we were operating at the wider scale of production at the main factory, we always tried to minimize our reliance on external producers of components that went into the production of the units. However, we only ventured into in-house production of components that did not require large fixed capital investments in production machinery. Therefore, we relied on local producers of items such as door handles and hinges as well as Israeli producers of glass and imported cooling systems.

However, the need for firms to expand their network with local subcontractors was seen as a sign of weakness. Therefore, most of those firms attempted to gradually reduce their reliance on such links by producing most of the components that went into their final product in-house. This however, was only possible with the more successful firms that had relatively stable access to the Israeli markets and were thus willing to invest in additional machinery and lines of production, particularly during periods of economic growth. During periods of economic slow-down (i.e, during the years of the uprising) these subcontracting networks expanded significantly and firms were forced to reduce their fixed capital investments for use as working capital by getting rid of some machinery. During periods of economic slow down and a decline in the consumption of their products, firms found it more feasible to purchase some of the components that went into their final product from small local producers who began to supply them with these components.

During the uprising we reduced our in-house production and increased our dependence on outside sources for the supply of some of the required components. During this period, the decline in the number of units that we produced, made it unfeasible for us to maintain a complete production line. During these slow periods, we could not afford to keep the machine that manufactured the shelves for example. Our consumption of shelves declined considerably and it became more feasible for us to sell the machine to a small local producer and began purchasing the shelves from them. This local producer started selling to other local producers of refrigerators which resulted in the drop in the small producer's production cost and thus a lower price of shelves for us.

Producers of basic consumer goods & consumer durables:

Firms of this type evolved from small scale maintenance operations that began to appear during the first and the beginning of the second phases of the Israeli occupation. The increase in the consumption by the local population of second-hand appliances purchased from Israel provided these producers with considerable sources of business. Many firms developed experience through the maintenance activities on the used and new appliances and were able to gradually imitate the simpler appliances or components of appliances for sale in local and Israeli

markets.

23- After that, I started to work on my own in the maintenance of electrical appliances, welding machinery and similar equipment. During that period I used to work for very long hours, over 10 per day. I concentrated on the production of welding machinery producing 10-15 welding units and then marketing them in the West Bank (WB). During my trips to the WB I also used to do a lot of maintenance work on welding machines at the locations that I delivered my products to.

Through their work with the wide range of appliances, those local firms were able learn the secrets of those products as well as their areas of weakness. Many began expanding beyond maintenance by starting the production of some of the more frequently required spare parts for the appliances. They used the parts for their own maintenance operations as well as for sale in the local markets. Some others ventured into the production of the entire product, especially when limited production capabilities were required. Examples of those products are electric heaters, gas lamps, manual metal cutters, electrical transformers and welding machines.

The production processes that these firms utilized were labor-intensive and used second-hand machinery at the initial stages. They also were very flexible activities, with the ability to produce a variety of goods within the same line of production. Flexibility was essential because of the small size of the local market, and the seasonal demand on most of these products and the competition with other local and Israeli producers. Firms in this category faced a great deal of difficulty staying afloat because of the ease of entry into the same line of production by other firms. The low cost of the machinery and the low level of technology and skill required in these lines of production made it less restrictive for such competition. Therefore, firms were constantly forced to venture into new lines of production and in search of product through which they could gain a comparative advantage over other local or Israeli firms.

21- The firm has diversified for two major reasons: first, to remain afloat during difficult times when the consumption of a certain product declines and the potential for others arise; second, to keep its workers engaged and remaining with the firm for as long a period as possible. "We have been following this system of moving from one product to the next, to keep the local competition from catching up with us and to prevent work stoppage during the slow season of production a certain product. Therefore, we try to produce goods that sell in the winter, during the summer months, while we produce summer products during the winter months and we also have products that are demanded throughout the different seasons. Therefore, we produce 7-10 types of products for sale in the local market and all those products are related to our production capability and are related to each other in many ways, especially in our experience and the machinery required for their production.

24- At this stage I felt that the production of welding machines was too time consuming and not profitable so I decided to shift to another product line. Using the same machinery, I

started producing other metal products such as metal shelving, metal furniture and construction carts. I also began contracting for the municipality of Gaza on electrical projects, the production of metal electric poles and garbage dumpsters. I also began producing transformers (stabilizers) which were in high demand in Gaza at the time due to the low electrical current reaching the houses and shops. I also produced electric battery chargers for local car battery shops. The production of metal furniture became wide spread in the Strip so I moved on to other lines of production. At a later stage also, the production of electrical heaters became very wide spread in the Strip at a lower quality and thus a lower cost, which forced me to move to another product line. I kept on producing the heaters whenever demand for other products that I was producing slowed down and greater demand was found for a better quality, higher priced electric heaters. Contractual work with the municipality was scattered throughout those years. The other products were introduced into the market sporadically depending on the seasons and local demand.

A comparative advantage over other producers could only be acquired through a technical leap by such firms and/or the ability to venture into lines of production that required a large fixed-capital investment in machinery. Once such a product is developed, the firm involved will concentrate its efforts on developing the product's specific line of production by introducing machinery that could reduce the firm's reliance on other external producers. This is usually done to reduce cost and to limit the possibility of imitation by other firms.

Gaining a comparative advantage over other producers has not occurred overnight for these local firms. Most have ventured into the production of their main product on a step-by-step basis in order to minimize the impact of failure on the entire firm, to compensate for the lack of access to formal sources of credit and to cope more effectively with new restrictions by the authorities and the changing economic and political conditions. This approach is also helpful in allowing the firm to master segments of the new production activity gradually. Many of those firms will begin by introducing the machinery required to produce components of the main product or machinery that could produce a smaller type of the main product.

11- The production of the complete washer began in 86-87. We began producing the items that went into the assembly of the whole washer gradually between 1985 and 87. We then reached the point where we were producing all the parts required for the assembly of the complete washer. During that period, we began the production of each item according to the demand in the market and substituting for the consumption of Israeli or imported parts and selling those parts at half the price. We used this gradual approach in order to avoid placing a large investment into all the required machinery at the same time. We also wanted to test our products in the market and find out their weakness in order to make the required adjustment before committing our selves to the production of the whole machine.

25- In 1984 I started the main production line that I ended up specializing in at the later stage. This was the production of gas containers. At the initial stage I had a friend who worked in Haifa at an Israeli factory manufacturing gas burner heads which they marketed in the Gaza Strip. I inquired from him about the method of production, sale price and access to local markets. After deciding that this line could be profitable I decided to begin production. I had to order a set of forms from an Israeli metal shop in Tel Aviv who requested a set of samples

which I acquired through my friend who worked for the Israeli factory in Haifa. I began this line of production right away. After that proved to be successful I moved into the production of gas lamps. I used the Japanese and Taiwanese products to develop this item.

26- When I realized the size of the market for the consumption of gas heads and gas bulbs, the logical progression of production for me to follow became very obvious. The production of the gas canister became the next step. I purchased an old hydraulic press which was abandoned at the shop of a friend. I had to carry out an extensive series of repairs and modifications to this machine (used previously as a truck tier press) to be able to carry out the new function.

27- I began producing the 1.5 Kg gas canister. Initially, I was producing 250 units per month which reflects the inefficiency of the production line and the equipment I was using at that stage. In addition to this new line of production, I also was producing a variety of my traditional products such as metal shelving, heaters, gas heads and bulbs, to provide a more stable source of capital for the new line of production which was not yet well established at this stage.

The firm that succeeds in controlling the market in the production of a certain item will continue producing other goods to fill in the gaps during declines in the consumption of the main product. The side products will become more closely linked to the main line of production, utilizing the same production machinery and skill and in many cases making use of the scrap metal that remains from the main production process.

19- Our production could be divided as follows: 75% for washers, 15% heaters and the remaining 10% for the production of the different items that we use to fill in the gaps. We also produce spare parts for our washer and the Israeli unit. We use all the scrap metal that is left over after the production of the washer in the production of a gas stove. This item is produced to fill in slow periods in our production of our main items. It is also produced when we have sufficient scrap materials left from the other activities. We also use the smaller stainless steel scrap for producing plates and pots.

37- I have been gradually thinking about reducing the scope of my production and concentrate on the production of gas related products, such as the tubes, gas heads, torches and stoves, in order to organize my production activity further and become able to produce larger amounts.

Firms that have succeeded in gaining an advantage in the production of a certain item, have gradually transformed that segment of their production activity into an assembly line system. This has occurred only when there is sufficiently stable demand for their particular product. Once these conditions are met, firms of this type will usually expand rapidly and move further towards mass production. In most cases, they have attempted to reach self-sufficiency in their successful line of production by limiting their reliance on external, local or Israeli firms for the supply of required products and services. This becomes more difficult to achieve when there is a need for fast and accurate production machinery requiring high fixed-capital investment. For those services, firms usually seek Israeli modern sector producers.

The relationship with Israeli producers has changed during the years of the uprising as a result of the disruption in formal flow of credit after the suspension of most local banking transactions. In most cases, Israeli producers have suspended their deferred payment plans for services they render to local producers. An exception to this rule is found in cases where sizable services are being rendered between local and Israeli firms that have had a stable relationship.

33- During the uprising, the relationship has changed between us and those Israeli firms in the method of payment . Most of them refuse to accept deferred payment and insist on getting immediate payment for the services rendered. The machine shop that we still have considerable links with, and large quantities of work done by, is sometimes willing to provide us with extended payment plans, because of our large volume of work with them. All the others however, are worried about how they could track us down in Gaza, during the uprising, if they wanted to collect.

Firms in this category that have not been successful in developing a product with a stable market niche will continue to produce a variety of goods and rely on other related local firms through subcontracting links. This will be done to reduce the fixed-capital investment in unstable areas of production. subcontracting out between local firms that have access to a limited market has increased significantly during the years of the uprising due to the general decline in demand and the unwillingness of firms to maintain additional lines of production. Their operations will gradually become assembly operations rather than complete production processes. However, these firms will employ a variety of methods to reduce the cost of their subcontracted services. This basic metal firm provides a good example for such a situation:

17- So our links are with the machine shop, the electrician who rewires the motor and also the plastic raw material supplier. However, we always try to minimize our dependence on external firms for such services unless we do not own the required machinery or we are pressed for time. The cost of producing an item outside at a local machine shop is 4 times our cost if we did the job in house. We therefore try to reduce our cost by requesting that our work be done when the machine shop has a slow production period and has time to work on our items. We never request work while the machine shop has a lot of work to do. So I always stop by the machine shop and inquire if they are busy. If I find that they are not, I request that they do some work for me based on an order that I have left with them to be filed during their slow time. The cost of their work during their slow time is usually half that of a full schedule. We try to do the same with other shops that we subcontract to. Even the electrician who rewires our motors does our work during his slow time and we usually try to make him do the work in our factory so that he could use our raw materials thus reducing the cost further.

12- We started upgrading some of the machinery, but we also sold some machinery that we used for the manufacture of some parts to small producers who specialized in the production of those items. We began purchasing those products from the new local producer instead of producing it our selves or buying it from Israel. We did this because we wanted to concentrate on the production of other items that were not available in the local market. Once we

transferred the production process of certain items to external producers, those firms began producing for a wider range of consumers which resulted in a drop in the cost of production.

Some producers of basic consumer goods in the occupied territories, have benefited considerably during the years of the uprising as a result of the boycott of Israeli goods by the local population and the decline in the consumption of competing imported products. The availability of local demand for their products made it more possible for these firms to formalize a considerable segment of their operations and gain access to niches in the Israeli market.

These changes resulted in the appearance of new firms within this category and the expansion of existing small-scale producers. The availability of a stable local source of demand helped firms within this category transform their lines of production from small-scale flexible operations to assembly line systems of mass production. One of the firms interviewed which was involved in custom tailoring prior to the uprising, shifted towards the mass production of standard products for direct sale in the local market. This firm made use of the experience in assembly-line systems of mass production that most local firms which had subcontracting relations with Israeli firms have managed to acquire during their years of operation.

The Uprising has been very beneficial to the tailoring branch of the local firm. Due to the initial disruption of links with Israeli firms and the local boycott of Israeli products, the owners directed their effort towards the mass production of finished goods for local demand. They capitalized on the experience of the subcontracting branch in introducing the new system of production and on the experience of the tailoring branch for the design and marketing of the final products. This resulted in the total alteration of the tailoring operation from one involved in the production of custom clothing, to one directly dealing with retailers by producing standardized products. This operation found a great deal of enthusiasm amongst local retailers who began facing difficulties in gaining access to Israeli producers for acquiring their ready made clothing. The call by the Unified Leadership of the Uprising for the boycott of Israeli produced goods, the reduction in the consumption of imported goods and the support of locally produced items, provided additional backing for such shift in target by local firms. The firm was also able to offer those local retailers a better price and a comparable quality. This operation concentrated on the production of sports jackets and when that was proven successful, they began the mass production of suits.

However, when too many firms entered into the same areas of consumer goods production, many collapsed or had to cut back. The obstruction of economic links between the West Bank and Gaza during the years of the uprising, resulted in the confinement of producers to their own territory and the subsequent reduction in the size of their accessible markets despite the increase in relative demand for local production which resulted from the boycott of Israeli products and the reduction in the consumption of imported goods. Prior to the uprising,

most of those producers had been able to gain a competitive edge over Israeli firms in those local markets, and some had gained access to niches in Israeli markets. This led to the growth of some firms and their shift towards mass production. Their confinement to local markets and the increased competition between them, resulted in the shrinking of their production operations and their shift towards more flexible lines of production.

V - FIRMS' SYSTEM OF OPERATION

5.1- Access to Markets.

5.2- Access to Raw Materials.

5.3- Access to Credit.

5.4- Access to Machinery.

5.5- Labor.

5.6- Location.

5.1 ACCESS TO MARKETS:

When the Gaza Strip fell under Israeli occupation in 1967, it lost all direct links to Egypt and to the markets of the rest of the world. Since the beginning of the occupation, all manufacturing firms in the Gaza Strip have been denied access to external export markets and have been confined to their local market and that of the West Bank, as well as an informal and highly restricted access to the Israeli market. Israeli goods, however, were allowed formal and unrestricted access to the markets of the two territories, making the survival of local firms through the transitional period an extremely difficult task.

During the initial years of occupation, the local industrial firms were reliant on whatever low-income and specialized small-scale demand was not satisfied by the unrestricted influx of low-quality Israeli products. The level of technical development of most local firms during this initial phase stagnated due to the small demand and the limited reinvestable capital generated in the local market.

The funds generated through retail activities between Israel and the territories during this initial phase, as well as the remittances from the increasing number of Palestinians employed as cheap labor in Israel, were gradually transferred for funding existing and new production activities that could compete with Israeli products in the local markets or gain access to niches in the Israeli markets. The interaction of local merchants with Israeli producers as well as the employment of local workers in the Israeli market, resulted in a better understanding by local entrepreneurs of the demands of the Israeli market and the weak points of Israeli or imported products that are sold in the local markets.

Based on this understanding of the Israeli and local markets and this development of links between local entrepreneurs and Israeli firms, retailers and suppliers of raw materials and machinery, local production activities of various characteristics and target markets began to emerge. Some concentrated on establishing links with the local markets. Some targeted demand in the territories and in Israel. Some targeted demand in Israel alone and others established subcontracting links with Israeli firms which marketed their products in the local, Israeli or export markets.

Even though local firms and entrepreneurs had gained knowledge about the Israeli market and established contacts with firms and retailers within that economy, gaining stable access to the Israeli market proved to be a difficult task for local producers. Local firms were

able to do so only through subcontracting for Israeli firms or through accessing certain segments of the Israeli market demanding low-quality, low-cost consumer durable goods. To accomplish this, local producers had to be able to reduce their production cost while maintaining comparable quality of production and to contact Israeli firms interested in subcontracting for their products. A small number of local producers were able to gain access to a wider segment of the Israeli market through their ability to reach a relatively high level of technical advancement and quality of production. However, these firms faced fierce competition from Israeli producers in the Israeli and the local markets and confronted concerted governmental opposition to their development at the local and, in some cases, the central levels.

The shifts in Israeli policy and the change in economic conditions in Israel and the territories and the eventual advent of the Palestinian uprising in December 1987, introduced a series of changes in the evolving patterns of production and target markets for most local firms.

The local pattern of consumption in the territories has been altered considerably during the years of the uprising as a result of a number of factors:

. A 70% decline in the average income of the local population because of the decline in the ease of access to employment in Israel, the slow-down of local economic activities such as retailing, production and agriculture due to a rise in the number of strikes and curfews, the intensification of the taxation collection system and the subsequent increase in the taxation rates.¹¹⁷

. The boycott by the local population of Israeli goods that had locally produced alternatives and the reduction in the consumption of imported goods and the support of local production by the population and the leadership of the uprising.

These new conditions resulted in a considerable reduction in total consumption by the local population and a shift away from demand for imported or locally produced luxury or non-basic goods. Local producers of basic goods witnessed a considerable rise in the consumption of their products because of the boycott of Israeli-produced basic goods. The consumption preferences of the local population also shifted. The number of festive celebrations in both territories declined considerably which caused a decline in the consumption of products used for these occasions such as confectioneries, extravagant clothing, and popular, local or foreign music. Patriotic songs and recorded or live readings from the Quran replaced popular Arabic and foreign music. This shift in taste transferred the control over this industry into the hands of

¹¹⁷ Roy, "The Political Economy of Despair," 61.

local recording shops and away from Israeli or foreign producers.

The attempt by the local population to challenge the ever increasing and suffocating reliance of the local economy on that of the occupying state exposed the vulnerabilities of local producers and their extensive dependence on the Israeli economy. The stepped-up restrictions on the mobility of the populations of the two territories and the flow of goods between their two markets resulted in additional limitations to the size of market accessible to local firms who, prior to the uprising, relied on the markets of the two territories and, in some cases, Israel. In this section, I will discuss the response of the various categories of firms to the changing conditions and shifts in Israeli policy. Based on the experience of the selected cases, I will identify the new marketing patterns that developed during the different phases of the occupation as well as the changes to this pattern that took place during the uprising.

Subcontracting Relations with Israeli Firms:

During the early months of occupation, Israeli firms began establishing subcontracting relations with local firms through which they could gain access to the mounting cheap labor supply of the territories and thus gain easy access to local markets and become more competitive in their local or export markets. The local subcontractors provided the Israeli firms with low-cost, labor-intensive operations in exchange for a continuous supply of business with limited concern about the marketing of the final product and were able to concentrate on their production activities and on increasing their attractiveness to the Israeli parent firms in order to maintain stable links.

Links between local subcontractors and the local markets never developed, and their understanding of local or Israeli demand remained very limited. The access to markets for the final products of such firms was guaranteed by the Israeli parent firms as long as demand for such goods in local, Israeli and export markets was available. The ability of the Israeli parent firms to gain free access to local, Israeli and in some cases export markets, guaranteed an ample source of work for local firms. Therefore, this line of production helped local firms bypass the problems related to marketing, the understanding of patterns of local demand and dealing with local or Israeli retailers.

24- The reason behind selecting subcontracting instead of direct production and sale in local markets, is the element of time needed for marketing the goods produced as well as the limited size of the market. The firm's owner found it extremely difficult to cope with the vagaries of

local demand, ways of dealing of the local clients and the fluctuating market. Since its creation, this workshop has been totally reliant on subcontracting activities for Israeli firms, and has not considered shifting towards a complete production activity to replace those subcontracting links, even during the uprising, due to anticipated marketing difficulties and the possibility of the development of a confrontation situation with the authorities.

The number of subcontracting firms increased considerably. Most were able to achieve a steady growth in their scale of production throughout the different phases of the occupation period and the subsequent shifts in Israeli policies, but began experiencing declines in production levels during the years of the uprising.

The decline in the average income of the local population during the years of the uprising resulted in a radical decline in their consumption levels. The boycott of Israeli products affected the sales of Israeli parent firms which had relied on local Palestinian consumption. One of the subcontracting firms interviewed faced this situation:

25- When the uprising started in 1987, the size of production at this firm was affected drastically. The Israeli firm that this firm subcontracted for, sold 30% of the finished products back in the West Bank and Gaza and the rest to Palestinian and medium to low income groups in Israeli towns and cities. Some Israeli firms that this firm subcontracted for, sold 50% of their products in the territories.

Sales by Israeli parent firms that were dependent on the Israeli market were also affected by the events and the economic slow down of the uprising. Many of the local subcontracting firms were forced to look for new subcontracting relations with additional Israeli firms in order to compensate for the loss of business from main parent firms.

Some local subcontractors began facing difficulties in obtaining the required clearance from taxes because of the increased tax estimates by the authorities and the inability of most firms to make full payment. Without the required clearance papers and a valid magnetic I.D card, local firms were unable to cross the border and make delivery of finished goods or pick-up unfinished materials from the Israeli firms. Most attempts to cross the border would result in an inspection of their goods and tax payment records which in most cases would end in the payment of additional fines.

The increased restrictions on travel between the territories and Israel during the uprising and the requirement of taxation clearance in order to gain entry into Israel, forced some firms within this category to suspend their relationship with the Israeli firms and begin directly producing for local markets. The increased competition between local subcontracting firms

searching for additional Israeli firms to subcontract for, contributed to a further shift by these firms towards targeting local markets.

The ability of firms in this category to make this transition was very limited because of their insufficient understanding of local consumption, the nature of dealing with local retailers, their limited experience in acquiring all the required raw materials and the development of a new production process without relying on the Israeli parent firms. Most of these firms were specialized in the production of a specific item during their subcontracting relationship and did not have the required flexibility to alter their production according to the requirements of the small local market and its continuous shifts. The large number of local firms attempting to make this transition resulted in significant competition for the limited local market. This was further exacerbated after access between the two territories was restricted, further limiting the available market for the producers of each territory.

Firms Based on Israeli Market Links:

Another type of subcontracting arrangements developed between local and Israeli firms. Through their direct employment with Israeli producers of basic metal goods such as commercial refrigerators, cooking stoves and other basic metal products, Palestinian workers were able to gain the skills required for the establishment of local workshops for the production of such goods. They were also able to establish the necessary marketing connections within the Israeli market.

26- After four years of employment in Israel, the owner established the basis of this firm and began the production of commercial size refrigerators and cold rooms for use in restaurants, supermarkets and produce and meat markets. Seventy to eighty percent of sales were in Israel and the rest were marketed in Gaza and the West Bank.

Capitalizing on their ability to lower production costs by tapping into the local cheap labor supply, these firms were able to push similar Israeli firms out of these lines of production. The products of these firms relied to a great extent on demand generated by activities in the Israeli economy such as restaurants, supermarkets, produce, fish and meat markets. Their links with local consumption were very limited. The number of these activities have declined considerably in both territories during the years of occupation and even further during the uprising. This was the result of the decline in scale of these activities during the continuous state of unrest.

Local producers were quickly able to control the Israeli market due to their lower cost of production. Some of the Israeli workshops that were involved in the production of the same items, became engaged in the marketing of units produced by their former Palestinian employees or moved into other lines of production. Others began moving into the production of more advanced and higher quality consumer durables after the production of the lower quality products was taken over by local producers.

The difference between these production activities and the direct subcontracting operations of other local firms in the occupied territories, was that these firms had to secure their own access to raw materials and develop their production processes without depending on the Israeli firms that purchased their products during the initial stages. The relationship between these firms and their Israeli marketing firms was gradually abandoned as the local producers were able to gain direct access to the Israeli market without relying on marketing assistance from these Israeli firms.

Most of these local firms remained informal during the 1970's. Many experienced considerable rates of growth and a significant expansion of their links with the Israeli market. They were able to avoid the formalization of their production activities until their access to the Israeli market became conditional upon the formalization of their status with the department of trade and industry and the production tax department. The pressure to become formal and begin paying production and Value Added Tax began in the early 1980's. The well established firms within this category were able to afford these new conditions due to the financial stability of their production activities and the relatively well established access to the Israeli market. Once formalized, such firms were not hesitant to establish formal links with other sectors of the Israeli economy, such as sources of raw materials or machinery, and further expand their operations.

During the 1970,s and 1980's, such firms marketed over 80% of their products in the Israeli markets, while the remainder was sold in the local markets of the Gaza Strip and the West Bank. The extensive links that firms in this category created with the Israeli market, and their almost total reliance on Israeli demand, prevented them from developing parallel local market links and resulted in very limited effort on their behalf to modify any of their products for local consumption during the years of their prosperity.

This proved to be an area of weakness during the years of the uprising when most of

these firms lost access to the Israeli market as a result of the disturbances and the increased border restrictions. Many of these firms were forced to alter their production within a very short period of time in an attempt to target local demand. Their limited prior links with the local market and their insufficient understanding of the character of local consumption made a transition more difficult. The rigidity of their production processes and their specialization in the production of specific items for the Israeli market during the previous years, made it extremely difficult for them to diversify. The inability of many of these firms to make a quick transition and to develop a well suited product for local consumption resulted in the collapse of many or the struggle of the rest to survive during a very difficult transition phase.

28- During the uprising, attempts have been made by this firm to redirect its production away from commercial refrigerators that are demanded by the Israeli market, towards small domestic use units that could be marketed locally. This attempt has not achieved definite results but consumption of small scale units has reached 3-4 units per month for use in offices or homes. One of the main barriers that have prevented a faster expansion of this production line in the local markets, has been the obsession of the local consumer with imported goods and the inferior quality of the newly introduced unit. But the main attraction of the newly introduced unit has been the lower price which is 2/3-1/2 of the price of an imported unit of a comparable size. In another attempt to compensate for the loss of the Israeli market, the firm began to assemble Israeli produced house refrigerators locally for sale in the local market at half the price of the finished Israeli unit.

However, some firms within this category were able to maintain sufficient links with the Israeli markets to continue in their original line of production. Their continued sales in the Israeli market afforded them the ability to maintain their formal status with the tax authorities and thus to obtain the required clearance papers for gaining access to Israel. However, the disturbances in the territories caused these firms many delays in production and delivery of their goods. The increase in transportation cost for such producers reduced their competitiveness in the Israeli markets.

The decline in the number of local producers in this category that continued to have links with the Israeli market and the increased difficulty of access between Israel and the territories, allowed Israeli firms previously involved in such production lines to re-enter. Furthermore, Israeli consumers of such products began to exercise a boycott of Palestinian products, further enhancing the position of the re-entering Israeli firms.

29-Israeli consumption of units produced locally has declined greatly due in the large part to difficulties confronted at the border crossing. Israeli consumers on the other hand became less willing to buy Palestinian produced units as part of the reverse boycott of Palestinian products. This feeling has been encouraged by the authorities through negative ads discouraging the Israeli consumer from purchasing locally produced goods. Israeli

refrigeration shops that were involved in the production of such units prior to the entry of Palestinian producers, started producing these units after local producers became unable to deliver their products to Israeli consumers. Palestinian workers who were employed by Palestinian firms in the production of refrigeration units, have largely been absorbed by these Israeli producers during the years of the uprising to manufacture such units for them in Israel. This has created a drain on the local labor force and has enabled Israeli producers to regain some of their ability to compete due to the low wages they pay Palestinian workers.

As a result of the increasing difficulties that many of these local firms began facing during the years of the uprising, some abandoned their local production plants and established branches in surrounding Arab states. The establishment of the firms outside the territories enabled them to gain access to alternative markets. Relocating to a neighboring Arab country became an attractive option for these producers especially because their access to export markets had been denied by an Israeli imposed ban on export for Palestinian firms located in the territories.

27- In order to compensate for the loss of access to the Israeli market, we tried to establish a production shop in Egypt but the difficulty of obtaining a residency permit was excessive. We were able to find an Egyptian partner fulfilling the basic requirement and we guaranteed the money as well as the sources of raw materials, but the residency permit proved to be the main obstacle. We would face the same difficulty if we were to attempt to establish a similar factory in Jordan.

The transfer of production activities to the surrounding regions began to resemble the drain of the local skilled labor force to the surrounding Arab states.

Firms Based on Local Market Links:

Firms within this category can be divided into two subcategories.

- 1- Firms that developed marketing links in the local and Israeli markets:
- 2- Firms that remained confined to the markets of the two territories and a limited access to the Israeli market.

In the following section, I will discuss the evolution of firms within this broad category and will then describe the marketing characteristics of firms that are based on flexible production processes vs. firms that are based on rigid mass production.

Most local firms were only able to begin effectively targeting local demand during the second phase of occupation. At that point, firms that had survived the transition from the period of Egyptian administration to Israeli occupation began to regain their footing and develop a new understanding of the evolving pattern of demand in the local and Israeli markets.

During the initial phase, these firms were overwhelmed by the influx of Israeli goods into the local market. Most of them were unable to efficiently establish new links with the Israeli economy through which they could gain access to raw materials, technology transfer and machinery. These links could not be developed by the majority of the surviving firms because of the limited contact that their owners had with the Israeli economy during that initial phase. The majority of these surviving firms, therefore, went through a phase of hibernation, and were only able to reappear when the conditions became more stable and they were able to develop some of their advantages over competing Israeli firms.

New firms started to appear during this second phase that targeted local demand. Many of these firms were set up by local entrepreneurs who engaged in trade activities with Israel during the initial phase, technicians who were involved in local maintenance activities and, in some cases, returning Israeli employed local workers. Through their interaction with Israeli producers and retailers, their accumulated experience from maintenance operations and their direct employment in the Israeli economy, they gained a better understanding of the the Israeli economy and its sectors, developed their knowledge of the local markets and established useful links with Israeli firms, suppliers of raw materials, machinery and services and compiled the required capital to initiate the new activities.

4- As links between the local market and the markets of Israel and the West Bank were gradually developed and a better understanding of the characteristics of the evolving local market and the gaps in the two other markets was achieved, some local entrepreneurs began venturing into production activities targeting those gaps as well as competing with Israeli producers for the local market .

Both surviving and newly established local firms relied to a certain extent on the Palestinian labor force that was employed in Israel for acquiring additional information about production ideas, sources of supplies and machinery and were able to convince some of these laborers to work for them and to directly transfer their newly acquired experience.

During the early years of this phase (early 1970's), these firms faced little difficulty in obtaining their municipal or production permits as long as they were not involved in the production of goods that were restricted by the Israeli authorities. The maintenance or small scale production shops were not required to register with the Israeli authorities because they were not recognized as production activities. However, the rigid producers had to abide by all the regulations, but faced minimal sources of competition from Israeli firms. The Israeli

authorities rigidly restricted the establishment of production activities that could provide local sectors with any level of control over their sources of primary goods. Cement, fertilizer, chemical production, chicken hatcheries and fruit and vegetable processing plants are but a few examples of restricted projects. Local farmers, builders and industrial producers were forced to remain dependent on Israeli or imported sources (imported through Israel) of such supplies and dependent on Israeli facilities for the processing of their agricultural surplus production.

The local firms that were allowed to function under formal or informal status faced a considerable amount of competition from Israeli producers who had unrestricted access to the local markets. However, local firms were gradually able to gain a competitive edge over Israeli producers by lowering their production costs through the utilization of the local supply of cheap labor, family labor and the use of second-hand machinery in labor intensive operations.

Because of the uncertain political and economic conditions in the territories, most local firms during all phases of occupation maintained a cautious approach to developing and expanding their lines of production. Local firms within this category have not invested in the production of certain luxury goods that are currently being imported from or through Israel. These firms have been unwilling to invest high initial capital which is required for expanding their existing or establishing new lines of production in order to begin producing a certain item and also due to the small and increasingly shrinking local demand for such goods.

Local firms relied on the actions of a few firms that were more willing to experiment with the local market, before they made a decision to venture into a certain line of production. This phenomenon led to the development of a pattern where a successful product line which gets introduced by a pioneering local firm will be copied and then quickly saturated by the entry of other local, existing or new firms. The inability of local firms to correctly judge the capacity of local demand for these products resulted in the collapse of many of these firms.

This phenomenon of imitation forced pioneering firms to maintain a flexible approach to production by moving from the production of one good to the production of another, leaving a gap between themselves and others. The difficulty that pioneering firms faced in maintaining an edge over new, incoming or existing firms was because of the similarity in cost of production amongst local producers and the inability of firms to keep product secrets because of the simple technical characteristics of most of their products.

In a very few cases, some local firms were able to excel over others in a certain line of

production. This was mainly possible if there were prohibitively high capital requirements for the entry of other firms or the result of technical leaps that these firms were able to make, leaving an effective gap between themselves and other local firms. There is no product protection for local producers against the entry of others in the same production line. Local producers also imitate Israeli production and have, through this technique, been able to drive many of the Israeli firms out of a significant segment of the local market. Local firms also use trade marks with names closely resembling those used by Israeli or imported products in order to gain access to local consumers who are hesitant about purchasing locally produced goods.

Firms Based on Local and Israeli Market Links:

Rigid Mass Production Processes vs. Flexible Mass Production:

There are two types of firms within this category. The first, which I will name “rigid mass producers”, are firms that entered a specific line of production which has extensive barriers to the entry of other local firms.¹¹⁸ The second, which I will name the “flexible mass producers”, are firms that evolved gradually from being flexible, producing a variety of products for local demand and were gradually able to gain control of a stable niche within the local market for the production of a specific product that was related to their initial area of specialization.¹¹⁹ Part of the reason behind the ability of firms within this category to safeguard relatively stable access to local markets and gradually Israeli markets, is in the high rate of fixed-capital investment required. Another reason, is the initial or the gradual introduction of modern production processes.

The rigid mass-production firms have, in most cases, entered and specialized in their final line of production from the outset of their establishment. These firms usually invested relatively large sums of start-up capital and introduced rigid, mass production manufacturing processes. Many of these firms were based on remnants of production activities that survived the transition in 1967 while others were established during the period of occupation, in areas of production that do not fall under the restrictions of Israeli policies. Many of these firms are owned by the wealthy families within the territories and initially faced fewer restrictions from

¹¹⁸ These are production activities that entered lines of production that are less restricted by Israeli regulations. The firms within this category were able to establish high fixed capital lines of production.

¹¹⁹ These firms were able to gradually compile high fixed capital investments in machinery. Their ability to reach a level of mass production is mainly a result of a technical leap through which they were able to produce an item which turned out to be too complex for imitation and requires high capital for the production machinery.

the authorities, as long as they were not competing with Israeli producers, and thus functioned within the formal realm.

The flexible mass production firms are typically initiated by maintenance technicians and were thus started with limited capital investments and a flexible production process, relying on small and changing niches (seasonal, low income or small-scale demand) in the local and Israeli markets. The initial phases of these firms' activities were usually within the informal realm and they have faced considerable difficulties with the restrictive policies of the authorities as their scale of production expanded. Most appeared in areas of production that are in direct competition with Israeli producers in the local and Israeli markets. But their gradual growth and their ability to function within the informal realm, hidden from the surveillance of the authorities, allowed them to avoid confrontation with these authorities during the most critical phases of their formation.

Many of these firms began as maintenance operations, capitalizing on the work generated from the influx of second-hand appliances into the territories from Israel. Their repair activities on appliances (Israeli produced or imported) gave them a good feel for the qualities of these products and their weak points. Their flexibility allowed them to vigorously explore the local market and its demand potential as well as the market opportunities offered by the Israeli economy. Through their explorations and experimentation with a variety of products, they acquired a wide range of technical experience and an in-depth understanding of the products and how to adapt them to local consumption demand.

Once these firms were able to guarantee their control over the production of a certain appliance or other type of product out of their wide range of products, they began their preparation for a gradual transition towards specialization in the production of that specific item. This transition occurred gradually. They began venturing gradually into the production of spare parts that were required for the maintenance and rebuilding of that specific product for direct sale or for use in their maintenance operations. This allowed them to gradually reduce reliance on the original Israeli dealers for the supply of these parts (the roots of import substitution). With time they were able to accumulate all production activities that were required for the completion of the production line of the particular unit. In most cases, these firms did not abandon the flexibility of their line of production and continued the introduction of multi-purpose machinery, capable of producing other related products during slumps in the demand

of their main line of production. The main line of production will thus be transformed into mass production system once demand in the local market is guaranteed.

Both rigid and flexible types of producers were able to flourish once they were able to guarantee a stable and sizable local market niche for their main product. Both firm categories initially confronted resistance from the authorities, although in varying ways. The rigid mass producers were in less conflict with the authorities because they operated within the limitations of government policy and functioned in subsectors that used to be less restricted by the authorities while the flexible producers functioned outside these limitations. This situation changed as the attitude of the authorities became hostile even to the elites of the local population once they were seen to be involved in economically viable and thus threatening economic activities. Both types targeted local demand and were gradually able to expand their sales to Israeli markets through informal Israeli agents and retailers. Both types also targeted the demand of the Palestinian population who resided in Israel (the pre-1948 population of Palestine who were able to remain after the establishment of the state of Israel) and were thus able to further expand the size of their accessible markets and increase the feasibility of mass production.

The real test for the viability of these two types of firms took place during the years of the uprising. The producers of basic necessities within the two categories were able to survive the transition of the uprising and in some cases expand considerably due to the decline of competition with Israeli producers in the local markets. Their enforced financial position that resulted from the increase in their sales during the uprising enhanced their ability to maintain clearance and formal status with the authorities despite the escalated taxation rates and restrictive procedures. These firms were willing and able to put-up with the added restrictions in order not lose their formal status which would confine them to the limited local supplies of materials, machinery and technical transfer. Their ability to maintain their formal status allowed them continued access to their already established links with the Israeli markets which further enhanced their ability to live with the increased restrictions and maintain their sales in both markets.

Both types of firms which were involved in the production of luxury or non-basic goods witnessed similar declines in their sales, but their response to these changes were markedly different. The rigid mass producer was forced to reduce the scale of its production to

correspond with the rate of the decline in demand and had no choice but to shut down the main plant if that level was too low to maintain viability. Most of these firms, however, attempted to avoid a shut down in order not to lose contact with the market and its trained workers. If, at that low level of production, the plant was not able to provide the required income for the dependents, some members of the extended family or the partnership were forced to branch out into other unrelated lines of production or seek other sources of employment. The rigidity of the main line of production and the machinery it utilized did not allow diversification and the production of a wider variety of goods that could have a better chance in the limited local market. The branch activity was rarely established in the same subsector and was in some cases used to subsidize the continued low-level functioning of the main plant. The main criterion for the choice of the branch activity is its economic viability under the current market conditions and not its relationship to the main line of production or the ability to make use of idle machinery and facilities.

The flexible mass producer responded to the decline in demand for the main product by using the machinery for the production of its other side products or the introduction of a new, related product line that could have a better demand. However, the firm will not abandon the main line of production and will continue with the production of the main item, but at an adjusted rate in order to maintain links with the market and retain its trained labor force in preparation for its reintroduction once conditions improved. These types of firms were rarely allowed to totally collapse. Their basic and retained flexibility was capitalized upon during hard times and guaranteed their continued survival.

Firms Confined to local markets:

Firms within this category could also be divided into rigid, high initial investment and flexible low initial investment firms. The main difference is in the extent to which they were able to control a stable and sizable niche in the local market. They were usually dependent on a small local niche and faced considerable competition from local and Israeli producers. The rigid producers were able to function within specific subsectors, but were forced to maintain a relatively small scale operation. The resistance that they faced was relatively lower than the flexible type, but their future confrontations with the authorities became identical in many ways.

The flexible producers were forced to remain flexible throughout the period of occupation, but were able to expand a certain segment of their production activity if demand in the local market required it. Their ability to gain access to the markets of Israel was limited because of the relative low-quality of their product and their inability, due to the limited size of the local market, to upgrade the technical level of their operation and thus compete with Israeli producers effectively, especially in the Israeli market.

The same outcome occurred during the years of the uprising. The producers of luxury goods amongst firms of this type were in most cases unable to continue while the producers of basic goods flourished. Some of the firms that were able to expand their production activities during the years of the uprising were able to follow in the foot steps of the mass producing firms and expand their sales to niches in the Israeli market as long as they were able to afford to remain formal and put up with Israeli restrictions.

5.2 ACCESS TO RAW MATERIALS:

The Israeli occupation in 1967 cut off the Gaza Strip from Egypt and its port facilities and cut off the Strip's residents from independent access to external sources of raw materials. The local manufacturing firms became totally dependent on supplies originating in Israel or imported through Israeli facilities. A limited access to some raw materials through Jordan however, was maintained for the producers of the West Bank through which, specific raw materials were allowed access, but double custom duties were levied on those goods by Israeli and Jordanian customs, while other basic supplies were only allowed through Israeli ports. The access to materials through Jordan was provided only for the inhabitants of the West Bank and not the Gaza Strip.

The inability of local producers to gain independent access to the majority of their needed supplies, and their growing dependence on Israeli port facilities, producers and import agents for acquiring them, made their products subject to an Arab League boycott. According to this boycott law, all agricultural and industrial goods produced by processing raw materials produced by Israeli producers or imported through Israeli ports are denied access to any Arab market.¹²⁰ Goods produced through the processing of materials imported through Jordan, were allowed access, but the number of local producers who were able to utilize such access and

¹²⁰ This is the outcome of an Arab boycott of Israeli products. for more details, see chapter two section 2.4.

confine their raw material consumption to this source of supply has been limited. This law presented local productive sectors with a significant barrier to the potential for expanding their target markets and thus limited their development.

Phase one (1967-1969):

During this initial phase, a large percentage of local production in the Gaza Strip, was dependent on locally produced or mined raw materials (wool for rug weaving and clothing, clay for pottery making, scrap metal for machine-shop activities and locally produced organic fertilizer for agricultural sector activities) while the remainder was provided by local merchants who gained an early access to Israeli sources. The consumption of raw materials by local firms was relatively low during this initial phase and many were also able to function on remnant supplies left over from the Egyptian administration period.

Access to raw materials for the newly established subcontracting firms were guaranteed access to raw materials through their links with the Israeli parent firms, while other local producers with other types of extensive links to Israeli productive sectors have begun constructing their access systems with the aid of their Israeli contacts. During this phase, local merchants began establishing contact with external producers of raw materials through Israeli agents. Some others established independent access to those external suppliers, but had to utilize Israeli port facilities and in some cases import agents. Local producers who have had stable links to external producers of raw materials prior to the occupation were able to begin consolidating such links during this phase and redirect the flow to Israeli port facilities. This was only possible after those firms were able to regain their footing and restart their production.

2- After the Israeli occupation of the territories in 1967, the firm consolidated its links with its European suppliers of raw materials and technical assistance through annual visits to those companies which continued into the years of the uprising. Those visits helped create and maintain a personal relationship between the local firm and the European producers which proved to be extremely useful in the later years.

During this initial phase, local producers were able to gain access to deferred payment plans through a variety of sources. Israeli agents of external sources of raw materials passed some of the payment plans they received from the original suppliers to local producers. Local producers who established or consolidated their existing direct access to external sources of raw materials were able to gain access to such payment plans through the local branches of Israeli banks by

establishing an extended letter of credit while others were able to gain access to such payment plans through the external suppliers themselves. Such deferred payment plans provided the recipient with a 60-90 day grace period, while port procedures (bonded, security checks and customs inspections) for clearing the imported goods required between 7-14 days and shipping usually required 14-20 days, thus allowing local firms enough time to process and market the product before having to make the full payment on the purchased raw materials.

8- At the initial stages of production, the firm began to directly import its required raw materials from various foreign destinations utilizing Israeli port facilities. The firm was able to establish a letter of credit with the local branch of an Israeli bank and make an initial payment equivalent to 25% of the value of the order. The firm would then complete the remaining portion of the payment at the time of arrival of the goods at the Israeli port. In some cases, the bank agreed to establish an open letter of credit, payable 60 days after the order was placed. This allowed the firm more time to receive, process and sell the goods before the final payment is due.

Phase Two (1970-1982)

During the second phase of occupation, the ability of many local firms to maintain their direct import operation with the external suppliers of raw materials, was reduced considerably as a result of an intensification of the port clearance procedures by the customs and security authorities. Once the goods were identified as belonging to Palestinian importers, they were directly transferred to the port bonded facilities to await a security check and customs inspections. The import firm became responsible for all costs related to conducting those procedures, while the port authorities refused any liability for any damage that could occur to the goods while they are in bonded facilities.

The time required for the clearance of goods from customs and security was extended to 20-40 days, in most cases leaving the importing firm very little or no time for processing the raw materials before having to make the final payments to the bank or the producing external firms for the acquired materials. At this point, many local firms were forced to resort to Israeli import agents for handling all port procedures in an attempt at bypassing the above mentioned obstacles. At this stage, all bank and external producer links remained with the local importing firms while the Israeli firm had to only help reduce the tension between those firms and the port authorities. The port authorities however were still aware that the imported goods belonged to the Palestinian firms because all the addresses on all enclosed documents were theirs.

The port authorities imposed a storage fee for the goods awaiting the security check which was paid for by the Palestinian importer who was not reimbursed for any damage to its imported goods during this period. This situation forced the firm to hire an Israeli import agent who took over the responsibility of dealing with port officials on behalf of the firm and

charged an average fee of 2-3% of the total price of the imports for his services. This procedure helped to a certain extent in bypassing the mounting confrontation between the firm and the Israeli port officials but was not sufficient to eliminate it completely. The goods were still being imported under the name of the Gaza firm which automatically subjected them to the usual treatment and delays even though the Israeli import agent was in charge of all port procedures but it did reduce the level of frustration experienced by the firm's administrators who previously handled this procedure.

The introduction of the Israeli agent to the port clearance phase reduced the tension between the local importers and the port officials, but did not succeed in significantly reducing the intensity or the destructiveness of the procedures. This forced many local firms to abandon the direct link with the external suppliers and the local branches of the banks, and pass it on to the Israeli agent. Importing all the raw materials under the name of the Israeli agent reduced the tension with the port officials. This arrangement however, resulted in the loss of most direct links between the local firms and the external suppliers of the raw materials which left local producers with a vulnerable access to extended payment plans, technology transfer and low prices of raw materials.

As the confrontations between the Israeli import agent and the port officials began to mount, the firm decided to begin importing all raw materials under the name of the Israeli agent, making him an important part of the link with the raw material producers. This procedure was adopted in 1984-85 and resulted in a considerable reduction in the problems faced at the port. Through this approach, the Israeli agent was able to reduce the destructiveness of the security checks as well as the fees associated with them and was able to free all goods from the port within 3-7 days from their time of arrival. The drawback to this procedure was that the local firm lost the ability to establish its own letter of credit through which it was able to obtain a deferred payment plan for the imported goods. The firm also lost access to the deferred payment plan offered by the raw material producer which ranged from 60-90 days after the goods left their port of origin. These plans became controlled by the Israeli importers and their willingness to pass such benefits to the local firm became mostly their decision and not an obligation, leaving the local firm at their mercy. As long as relationships between the Israeli agents and Palestinian firms were smooth, the firm faced limited problems with this arrangement. But when relations began to deteriorate during the years of the uprising, the link became increasingly vulnerable.

Phase Three (1983- present):

The decline in contact between the local firms and the external producers of raw materials proved to be detrimental to the future of many local firms. The access to raw materials for most of those firms became increasingly vulnerable as the border restrictions were increased and as all payment plans became only accessible through the Israeli agent. Local producers who lost all direct access to suitable payment plans through the local branches of Israeli banks or the

external producers of raw materials, became reliant on the Israeli agents for the provision of such services. The unwillingness or inability of those agents to provide such services forced local firms to increase their working capital, thus gradually draining other segments of their production activities or their personal assets. In many instances however, Israeli agents were willing to provide local producers with a sufficient level of services as long as their commercial relationship with those producers remained profitable. As long as those producers maintained a high level of production and sales and required the importation of large quantities of raw materials, the Israeli agents were able to afford passing on to them some of the benefits they acquired from the external producers of raw materials. Once the amounts of materials required by those local firms declined as a result of the decline in sales during the years of the uprising, all such services were suspended. It became unfeasible for the agent and the external producers to make small shipments of raw materials. At this point, local producers lost total control over their access to raw materials and were also unable to maintain their previous links with the same Israeli agent for acquiring their required materials. Those producers were forced to search the Israeli and local markets for better bargains on small amounts of raw materials.

9- The advent of the Palestinian uprising in December 1987 resulted in a decline in the level of production of the firm and thus a considerable decline in its raw material consumption. As those amounts declined, it became unfeasible for the firm to place private raw material orders through the Israeli agent due to the small size of required supplies. At this point, the agent became totally in charge of the entire operation with direct contact with all the sources of inputs that the firm introduced him to at the beginning of the relationship. The agent became an independent importer of raw materials for direct sale to producers in the Strip and Israel as well. The local firm was gradually forced to look for materials imported by different Israeli agents in the Israeli retail markets, in search for the lowest price.

The decline in the levels of production and sales for many local producers during the uprising was followed by a decline in the available working capital for those local firms. This limited their ability to make large purchases of raw materials at whole sale prices and were forced to make frequent trips to Israeli supply sources. The need for making frequent trips for acquiring raw materials further exposed those local firms to border crossing difficulties and more frequent taxation inspections.

The deterioration in relations between the two communities and the decreased mobility between the two regions during the years of the uprising made Israeli retailers of raw materials increasingly insecure about extending deferred payment plans to local producers or accepting

checks as a result of their inability to keep track of those local producers in the midst of the widespread disturbances in the territories. Those retailers began demanding on-the-spot cash payments for all purchases.

10- Looking for good bargains on raw materials in the Israeli retail market requires the firm's buyers to make many trips to Israel which increased their vulnerability to taxation checks at the border crossings and increased the firm's exposure to the scrutiny of the taxation officials. The inability of the firm to purchase large quantities of materials reduced its ability to get low wholesale prices on any of the required supplies unless the importer had leftover merchandise or was able to gain access to bargain shipments of the required materials and was willing to sell at a lower price to local producers. Prior to the uprising, the firm was able to get deferred payment plans on raw materials acquired from Israeli retailers. This was no more the case during the uprising as a result of the deteriorating relations between the Israeli and Palestinian communities. Israeli retailers began demanding cash payments for any purchase by a Palestinian producer

Local firms, who maintained a stable or increasing level of production during the years of the uprising through sales in local and Israeli markets, were able to continue the import of large quantities of raw materials and thus continued to enjoy stable relations with their Israeli raw material importers. Their ability to guarantee a sizable source of demand for their products in the local market as a result of the local boycott of the products of their Israeli competitors, enabled them to afford to maintain a clear record with the tax departments and thus remain formal. Their continued formal status allowed them border access which enabled them to maintain their links with their formal Israeli suppliers of raw materials.

1- The firm's ability to maintain its high level of production and sale during the years of the uprising was instrumental in maintaining its direct links with the European suppliers of raw materials and production equipment. This was possible because the firm was able to continue importing large amounts of raw materials and equipment during those later years, maintaining the feasibility of direct links with supplying European firms.

Those firms however, continued to confront haphazard taxation and security checks along border crossings between the territories and Israel, despite their clear record with the taxation departments and their formal status.¹²¹ Such firms therefore continue to try to avoid confrontation with the border officials by transporting their required raw materials and making their finished goods deliveries during the time when Israeli tax officials are not present at the border check points. This attempt has not been always successful, especially when the army officers decide to ground the goods until a taxation official is present at the scene.

¹²¹ Most of the incidents of border harassment by tax officials are an outcome of the refusal of the central tax departments to adjust the computer tax records to represent the final agreed upon payment. see chapter four, section 4.3.

Even though such firms continued their high levels of production and maintained their links with the Israeli importers of raw materials, their loss of direct access to the external raw material producers had a negative impact on their operations and increased the vulnerability of their relations with the Israeli importers. This vulnerability became obvious during the years of the uprising when the Israeli importers began refusing to extend deferred payment plans and in many cases insisted on cash deposits equivalent to 75% of the value of the raw materials before the placement of the order and the establishment of the letter of credit. If the materials were available in stock, most of the Israeli agents began insisting on cash on-the-spot payment for any purchase. The shortage of working capital amongst local producers due to the nonexistence of formal credit facilities forced them to make smaller, but more frequent purchases. This resulted in higher prices, an increase in the number of trips and more exposure to border inspections. The increased difficulty of movement of those local producers during the uprising made it increasingly more difficult for them to inspect the quality and technical specification of the material before it left the Israeli agent's warehouse. Some firms however, recognized the value of maintaining stable independent links with external suppliers of raw materials since the start of their production activities, even if the Israeli agent was in-charge of the import procedures. Those firms made sure that their relationship with the external producers remained undisrupted and the link between those producers and the employed Israeli agent occurred under their direct supervision and was never allowed to be a direct relationship.

4- The only link that the Israeli import agent has with the European producers of raw materials or machinery is provided under the instructions and supervision of the local firm, who remains in continuous contact with the European suppliers. The European raw material suppliers will not respond to any independent requests by the Israeli agent, unless they receive notification from the Gaza firm. The European firms have designated the local firm as their authorized and only dealer in Israel and the territories and have stated their unwillingness to deal with any other Israeli or local importer or producer, unless instructed otherwise by the local firm. Due to the nature of this arrangement, the firm has not witnessed any difficulties in dealing with the Israeli agent and this relationship was not affected during the uprising.

All orders and communications were made by the local firm and not the Israeli agent. A direct link to the sources of technical transfer and innovations that were traditionally gained through those external firms, was always safeguarded. The local firm maintained its position as the authorized agent for those external firms in the territories and was thus the only authorized channel through which any of those firms' products could be marketed. The Israeli agent was

thus hired to provide the firm with a limited and well defined service which was kept at that throughout the duration of his relationship with the local firm thus limiting the sources of vulnerability in the local firm's access to its required supplies of raw materials.

Through direct contacts with the external firms, the local owner maintain full knowledge of the specifications for all required raw materials, the placing of orders and import procedures as well as the prices of the various goods and the deferred payment plans provided by the European producers. The ability of the firm's owner to travel to the headquarters of those firms provided him with first hand knowledge about the various payment plans and specifications and the selection of the most suitable raw materials.

5- All raw material orders are placed by the owner during his annual visits to the European companies or through direct correspondence between the firm in Gaza and those companies with no assistance from the Israeli import agent. The raw material specifications, prices and payment plans are also agreed upon between the the local firm and the producers during the trips or through direct correspondence.

During the years of the uprising, these types of firms were able to continue their successful and stable relationships with the external suppliers of raw materials as long as they were able to maintain a high level of production and continued to require large amounts of raw materials. Palestinian agents of raw materials who maintained good links with external firms were in a position to play an important role in supplying local producers with their needed supplies. Those agents were very few in number and faced the same types of difficulties in maintaining their direct links with external sources of materials even though they had been operating as the authorized dealers of those external suppliers for a long period of time. Many were forced to rely on Israeli import agents for facilitating their import procedures and have thus become increasingly dependent on those agents. Some local agents faced increasing competition from their Israeli counterparts who were agents for similar goods in Israel. On a number of occasions, Israeli agents were able to persuade the external suppliers of raw materials to suspend their relationships with their local agents if they were interested in gaining access to Israeli markets. Those Israeli agents were more likely to succeed if the local agents were unable to offer the external raw material producers with a sufficient market or if the relationship between those external firms and the local agents was undeveloped. In some cases however, local agents are able to fight back by threatening the external firms that they would

report their actions to the Arab Boycott Committee which could lead to the loss of the external firm's access to all Arab markets.¹²²

32- I faced another major problem in obtaining the valves for the tubes which I obtained through a local importer who was the dealer for the Italian firms producing these items. The local importer was their authorized agent for the Gaza Strip and they had another Israeli agent who was the Israeli company. The Israeli company placed pressure on the Italian firm to cancel the agency of the Gaza Strip importer and to make them the main and only agents for it in Israel and the territories. The Italian firm canceled the privileges of the local importer and informed him that he could obtain all his requirements through their Israeli agent.

33- The local agency had come into existence during the Egyptian administration period, prior to the Israeli occupation and thus continued to be the authorized dealer for the territories. The local firm sent a representative to Italy to speak to the firm in order to try to change their decision. The representative informed the Italian firm that he was going to report this situation to the Arab Boycott Committee which is in charge of uncovering links between Israel and foreign firms. This could lead to a total boycott of the firm's products by all Arab countries. The Italian firm changed their decision immediately and attempted to regain the letter it sent to the local agent through which it informed it of the suspension of its privileges.

5.3 ACCESS TO CREDIT:

For reasons given below local branches of Israeli banks have not been a viable source of credit for most local firm throughout the occupation period. Most firms relied totally on the personal resources provided by their owners, their extended families or partners. Some local producers rely on short-term loans from local money lenders as a source for their working capital. Most funds however, are generated from on-going or previous trading, or investments, or from the sale of real estate. Local firms also relied on remittances from Palestinian workers in the Gulf States and in Israel.

11- I depended mostly on funds that I was able to save, or borrow from extended family members. I went through a long phase of only spending on upgrading my equipment and did not pay attention to my clothing and other family requirements.

12- I have been dealing with the local money changers. I have been taking short term loans whenever I need. This source is very limited. They are unable to extend long term loans and the longest is for 30 days, but they are willing to give me large amounts. My dealing with them is in the Dollar and the Jordanian Dinar.

The services provided by the local branches of Israeli banks have been limited to basic transactions aimed mainly at facilitating transfer of funds from the local economies to that of Israel. Local firms carried out basic financial transactions with those branches in the form of

¹²² The boycott of Arab states of Israeli products and of firms that deal directly with Israel could play an important role in putting pressures on external suppliers of raw materials and machinery to treat their Palestinian agents with the same level of professionalism with which they deal with their Israeli agents.

current checking accounts. The local branches were under the control of a “Military Examiner of Banks” who controlled bank activities and kept their services to the minimum.¹²³ The branches, however, offered useful import credit facilities that were used by local importers and firms for the import of raw materials and machinery. But these services were rendered useless as obstacles facing local importers at all Israeli port facilities were reinforced during the later years of the occupation. They were later suspended gradually and formally terminated during the uprising.

The Israeli banks were never a source of long term loans for local producers, but offered an overdraft service on the checking account at a high interest rate. For short term loans, the banks required the signature of four local business guarantors prior to the review of any application. The firm maintained an account with the local branch of the Bank of Palestine which offered a checking service only and was totally under the control of the Israeli Military Examiner of Banks. This bank was unable and unwilling to extend any additional credit services to its customers because of the deteriorating economic conditions, the excessive taxes levied by the authorities on its income (37%) and the extensive restrictions on its transactions.¹²⁴

During the uprising, local branches of Israeli banks relocated to border crossing points for the protection of their Israeli employees which made them more difficult to reach by their local clients. The banks also reduced their financial services to just the basic current checking account. This reduction in services resulted in the decision by many local firms to terminate their account with the bank, out of the feeling that the fees collected to maintain their accounts were higher than the benefits reaped from these relationships. Bank accounts became increasingly targeted by the taxation authorities as a means through which they could monitor the economic transactions of local firms. Checks that local firms used to issue to Israeli producers or agents of raw materials or machinery, provided the authorities with information about local firms’ contacts in Israel. They then used this information to further expose the activities of these local firms. This problem prompted many local firms to permanently terminate their links with banks unless their transactions would be uncovered through other means anyway.

8- *“We can’t deal with the local banks for our working capital by taking out loans. The interest*

¹²³ See chapter two, section 2.4, finance.

¹²⁴ UNCTAD, “The Palestinian Financial sector,” 86.

is higher than our profit rate. We used to rely on the basic bank services by issuing postdated checks as payment for raw materials and machinery and cover them before they were due with funds generated through the sale of the products processed from the purchased raw materials. Our activities have always been short term. We can't afford long term financial activities with these banks. We established an account with the Bank of Palestine until the uprising . We then closed our account or reduced our transactions because the authorities began obtaining our record from the bank. They reviewed our accounts and the activities that they reflected, in an attempt to uncover more of our sales and transactions. This made it too risky for us to maintain an account with any bank".

The suspension of relationships with Israeli banks and the inability of local firms to use bank checks through the Bank of Palestine in transactions with Israeli firms, transformed all their transactions with their Israeli suppliers of raw materials, machinery and services to the use of on-the-spot cash. Israeli suppliers would not agree to extend any deferred payment plans to most local clients. This forced many local firms to rely on personally generated funds as working capital during a period of economic hardships. The decline in sales for the majority of firms during the uprising, and the inability of most local producers to obtain timely payments from their clients, made raising sufficient funds for use as working capital a major problem.

The loss of extended payment plans from sources of raw materials presented local firms with another problem. The lack of such payment plans, limits the firm's ability to purchase all the required inputs and forced firms to make small purchases at a time, resulting in increased prices and additional transportation costs for transporting and locating the small quantities. The loss of payment plans also contributes to the local firms' inability to offer extended payment plans to its customers. This has limited the ability of retailers to purchase the products of these firms and they have had to look for alternative sources through which they could obtain suitable payment plans. These payment plans could only be afforded by Israeli producers who themselves get such plans from their suppliers of raw materials or have access to formal sources of affordable credit through branches of Israeli banks.

It is widely felt by local producers that local and international funding institutions have not done as much as they could in aiding the development of the industrial sector in the territories. Local institutions have concentrated their attention on areas of health, education and services and have not ventured into the funding of the productive sectors with the same intensity. This is both because of restrictions from the authorities and their lack of knowledge about the local productive sectors. This lack of knowledge has led to the misallocation of funding and the provision of unessential services.

Local nongovernmental organizations have not provided any of the firms interviewed with funding and according to many of the firms' owners they only fund people with whom they have a vested interest or a clan relationship. However, their fund allocation is not seen to be based on the feasibility of the projects funded. According to one firm owner involved in the manufacture of basic metal products:

7- "We rely totally on our personal funds and the funds we generate from our ongoing production activities. External funding from NGOs and other local and international agencies is always allocated to people close to the officials in those organizations and usually goes partially towards funding untested projects that in most cases result in failure. It seems that their aim is to expand the production activities in the territories but not to reinforce and strengthen the existing ones. If funding is allocated to existing and well tested projects then we can guarantee success. The remainder of such funds are usually allocated to individual housing projects or real estate investments".

However, most of the firms interviewed did not identify the lack of formal sources of credit as the major obstacle to their development. Most suggested that if they were allowed to gain equitable access to the Israeli markets and an unrestricted access to external export markets, they could generate the required funds for their future operations. Through an unrestricted direct access to raw material suppliers, local firms could gain sufficient access to deferred payment plans which ended up in the hands of Israeli raw materials agents after the intensification of import restrictions for local importers and producers.

Despite of the massive obstacles confronting local firms and the disadvantages they have to cope with in comparison to their Israeli competitors, many local firms have been able to survive and in some cases flourish. The ability of the owners of these firms to diversify their sources of income, has helped them cope with fluctuations in the general economic situation and the increased restrictions on certain economic activities. Their flexibility is therefore not confined to their production activity. Branch production activities, trade and retailing, remittances from members of the extended family employed abroad are used compensate each other's declines.

2- The firm entered this line of production with the intention of investing the sum of \$250,000 in machinery and equipment. The source of this capital investment was the used car business that the extended family was involved in prior to the establishment of this firm. Most of this amount was spent on the weaving machinery, while the cost of construction of the plant was included with the cost of construction of the extended family residence. An additional \$100,000-\$150,000 had to be available at all time in working capital to cover the cost of raw materials and other supplies and expenses. The source for this had to be from the families personal funds because they were unable get credit from local financial institutions and they were denied deferred payment arrangements by Israeli raw materials importers and machinery dealers during the initial years of production. The future working capital, the cost of the

additional equipment required for the dyeing plant (\$100,000) and the additional cost of construction which was required to house the later expansion of the plant (\$40,000-\$60,000) were covered by reinvestment of profits made during the initial 3 years of production (1985-88). The total capital investment in machinery and structures approached \$350,000-\$400,000 by 1989-89. The firm does not feel that credit represents an obstacle to their operations.

This is not to suggest that formal sources of affordable credit would not be useful under the current conditions in the territories, but as long as the restrictions on local firms' access to markets, excessive taxation and endless regulations remain, the usefulness of such credit facilities will be limited. Under the current conditions and the lack of protection for the local population of the territories, the Israeli authorities and economy will be the main beneficiaries of such credit because their ability to eventually siphon most funds entering the territories through their taxation systems and their control over the pattern of development of local productive sectors and the pattern of fund allocation by local or international agencies.

5.4 ACCESS TO MACHINERY TECHNOLOGY TRANSFER:

After the occupation of the territories in 1967, industrial machinery available to local producers became limited to second-hand equipment from Israeli sources and Israeli produced or Israeli imported machinery. Direct access to external sources was obstructed. All links had to occur through Israeli dealers or import agents. Local dealers in industrial machinery who functioned prior to the occupation and had been able to continue relations with external producers of such machinery, steadily lost control over their import operations as a result of the increased restrictions at Israeli ports and increased competition from the more financially capable Israeli agents.

During the transitional phase (1967-1969), the production activities that survived the disruptions caused by the occupation relied on the old stock of machinery that was available in the territories from the prior administration period. This machinery could not provide local producers with the required edge to compete with the better equipped Israeli production firms whose goods began flooding local markets. The local producers were only able to maintain a subsistence level of production, relying on the remnants of their traditional niche in the lower income local market.

subcontracting for modern sector Israeli firms, a process which evolved during this initial phase, made immediate links with Israeli suppliers of modern machinery for local

businesses. These firms developed only insignificant connections with the local economy for the supply of parts and maintenance of their modern machinery. Since local maintenance and spare-parts capabilities were not adequate to provide the required services, the subcontractors had to rely totally on the Israeli maintenance sectors. Over time, the local sectors and subcontracting firms were able to develop some of their own maintenance capabilities and have thus reduced their reliance on Israel for required services.

During the second phase of the occupation, a number of local firms in specific subsectors began to appear. Local entrepreneurs capitalized on a better understanding of local demand and a considerable amount of technology transfer and contacts with the Israeli economy compiled by the local labor force employed in Israel as well as through the trade relations between the two economies.

During this period, the majority of the newly emerging independent firms targeted local demand during their initial phases of production with the future goal of expanding to the Israeli markets.¹²⁵ To reduce cost and initial risk and to allow opportunities for experimentation, many targeted the stable niches in the lower-income demand of local markets until they mastered the production process and gained a better understanding of their target market and then gradually shifted their target to include the local higher income demand.

During this initial stage, local firms minimized their initial fixed capital investments by purchasing secondhand machinery which they obtained from Israeli used machinery auctions. This allowed experimentation with new production lines and product quality, without risking significant financial risks if the machinery was damaged. The use of secondhand low-tech machinery helped local firms gradually develop their understanding of new production processes and develop their ability to handle the technical requirements of the newly introduced machinery. These firms altered the machinery and its production capabilities, using in-house technicians and specialized local maintenance personnel, and often could reduce their maintenance costs by relying on other acquired secondhand machinery for the supply of spare parts.

1- The partnership decided to venture gradually in this line of production (textiles) by minimizing initial capital investments through the use of secondhand machinery obtained through machinery auctions in Israel. The use of secondhand machinery allowed the firm to experiment freely with the new production techniques and production quality, without running the risk of damaging expensive equipment. Additional used machines were utilized as a source

¹²⁵ Independent firms vs. firms with subcontracting links to Israeli firms.

of spare parts for the working equipment.

The processes of experimentation and alteration to the machinery helped firms develop links with local maintenance shops, machine shops, electricians and mechanics. Therefore, use of this machinery gradually helped develop the local capabilities among the in-house and external maintenance staff in preparation for the future introduction of more technically advanced production equipment. These firms thus avoided total reliance on Israeli maintenance shops and specialists when the modern machinery was later introduced.

A major drawback to relying on secondhand machinery is that local firms were unable to obtain access to formal sources of technical assistance, training and maintenance. Attempts by the local firms to make contact with the original owners or importers of the machinery were seldom successful. Even when the firms were able to make such contacts, they usually found the services which could be obtained and the available spare parts to be too costly. This forced local firms to rely on experimentation and informal trial and error methods for developing their technical capabilities. The quality and efficiency of production was held back because of these limitations, so local firms were not able to compete with Israeli modern sector producers in the higher income segment of the local market. When technical innovation beyond the local informal capabilities were required for the resolution of production problems or the development of the lines of production, local firms were forced to rely on Israeli engineers who were able to provide formal technical assistance but always at a high cost. These services did not provide firms with viable access to formal technical assistance and therefore were only used in emergencies or when there was no hope of finding local assistance to do the job.

2- The Israeli merchants of the second-hand machinery did not provide the purchasing firm with any technical assistance or training on the machinery. The initial Israeli agents of the used machinery were no longer willing to provide services because all warranties on the machinery would have expired. Some of those agents were no longer in existence at the point of this second purchase. Contacts between the firm and the external producers of the machinery could also not be developed, which meant that the firm had no opportunity for a technical assistance link or formal technical training programs with the machinery producing firms. Most of the required services were obtained from an Israeli textiles engineer who provided the firm with invaluable production assistance and maintenance tips during the initial years of operation.

Local firms gained no access to special payment plans when they purchased secondhand machinery, and were always forced to make cash payments. The machinery did

not come with any form of warranties. Thus the local firms were left responsible for problems that might arise after delivery.

The transition by those firms from targeting the low-income segment of the local markets to targeting a wider range of local consumption, as well as gaps in the Israeli markets, required the introduction of modern machinery in order to produce higher quality products that could compete with the Israeli products in all of these markets. As familiarity with the production process and the manufactured products increased, and as reinvestable capital generated during the initial phase became available, local firms that used second-hand machinery were ready to make the gradual transition towards the use of modern machinery. Through their use of modern machinery which guaranteed higher quality production, their newly developed understanding of the local and Israeli markets, as well as their ability to maintain a low cost of production due to their use of cheaper labor, some local firms were able to push some Israeli producers out of the local markets and in some cases gain access to niches in the Israeli market.

When firms began purchasing machinery from formal machinery dealers in Israel, they were sometimes provided with an adequate level of services and deferred payment plans, but were not provided with formal technical training programs that are usually provided at the expense of the manufacturer, if the machinery was technically advanced and expensive.¹²⁶ This gap in the services provided by the Israeli dealers left firms dependent either on the local maintenance sectors, which although they were developing were still informal, or, on the Israeli maintenance sectors at a much higher cost. Thus expense of maintenance and technical assistance provided by Israeli dealers forced firms to look for independent sources of maintenance which, while usually cheaper, were not guaranteed. Some local firms have simplified the electronic controls systems on their newly introduced modern machinery after having faced problems that could be solved only by Israeli maintenance engineers. These simplifications allowed the local firms to conduct most of the repairs in-house or rely on local maintenance personnel.

Because local firms could not make direct contacts with the external machinery manufacturers, they were not able to make use of the payment plans offered by those firms. Any deferred payment plans had to be obtained from the Israeli dealers who were often

¹²⁶ the average cost of the machinery in some of the cases was between \$30,000-\$90,000.

unwilling to extend the same plans that are offered by the producer. The willingness of those dealers to pass on benefits to their Palestinian customers was by no means guaranteed and has decreased with deteriorating political conditions. Since local firms could not directly import machinery (in their own names) because of the import restrictions on Palestinian importers, they could not open the letter of credit with the local Israeli bank through which they could gain a deferred payment plan. If direct import was possible for local producers, they could maintain direct links with the external machinery manufacturers. Through those direct links, they could gain access to the previously-mentioned payment plans directly from those external firms and to sources of technical transfer without reliance on their vulnerable links with the Israeli importer.

6- The firm later introduced new machinery which was purchased through Israeli dealers. The relationship between the firm and the Israeli dealers has been stable ever since. Those dealers have provided the firm with appropriate advice on the type of machinery required for the performance of the various production operations, and also provided the firm with tips on production techniques. Those dealers provided the firm with a stable supply of parts and maintenance during the period of warranty. The dealers have also provided the firm with some payment plans (deferred payments and monthly installments) and their relationship with the firm was strictly based on commercial factors and was rarely affected by the political circumstances except during the later years .

- The dealers did not provide the firm with a link to the foreign producers of the machinery through which the firm could have gained access to technical training and assistance nor did the dealers provide that formal training and technical assistance so the firm had to rely on the catalogs and trial-and-error attempts by its technicians to solve many of the problems. As a result of the high service cost provided by the dealer, the firm had to search for alternative service maintenance in Israel which could do the job at a lower price .

Other local firms that continued their reliance on the low-income segments of local demand were unable and unwilling to fully formalize their production activities and expand their links to include formal local and Israeli sectors and continued to use secondhand machinery. These firms were unable to deal directly with formal Israeli sources of machinery primarily for two reasons: first, they could not afford the high price of modern machinery and second, they could not risk exposing their economic transactions to the taxation authorities through their payment of the VAT tax and the issuance of official receipts through such transactions. These firms maintained their dealings with informal sources of secondhand machinery both in Israel and in the territories.

Other local producers who had links with informal retail sectors in Israel, were unable to afford the introduction of modern machinery so as not to increase their fixed-capital

investments and reduce their working capital. They also continued to rely on labor-intensive operations and secondhand machinery, and limited their links in Israel to the informal segments of that economy, since they were unwilling to expose their transactions through dealing with formal Israeli machine agents.

During the third phase of occupation (1983-1987), newly established firms targeting the high income local demand and niches in the Israeli market were forced to initiate their production by using modern machinery in order to compete with local producers using similar machinery and with the more advanced Israeli and foreign producers. Whenever these firms were unable to introduce new machinery to all segments of their production lines for lack of capital, secondhand machinery was used. It became very important and economically feasible for new firms as well as existing firms during this phase to achieve a high level of self-sufficiency in order to reduce their reliance on Israeli or local firms for the production of any component or the provision of any service that went into their finished product. Only firms that were able to guarantee stable access to niches in local or Israeli markets saw self-sufficiency as a goal. Firms that were limited to small and unpredictable niches in local or Israeli markets had to remain flexible and rely on extensive links with local and, to a lesser extent, Israeli firms.

The experience of this textile firm with Israeli dyeing and textile finishing plants might shed some light on reasons behind aiming for self-sufficiency and reducing reliance on Israeli producers:

9- In 1988, the firm decided to invest into a secondhand dyeing plant in order to reduce its reliance on Israeli firms for the provision of this service. The weaving cost of one kilo of textiles was \$3.00 while the dyeing cost at an Israeli firm was \$3.5 per kilo. Israeli dyeing firms mistreated local firms and gave a higher priority to Israeli firms. During periods of heavy textile demand in local markets, Israeli dyeing plants would hike up their prices to \$4.5/kilo instead of the standard price of \$3.5/kilo. The Israeli firms were able to raise the price for local producers because they realized that there was no local dyeing plant.

During this phase, local firms began facing coordinated resistance by Israeli firms against their attempts to purchase secondhand machinery which could help them reduce their reliance on Israeli firms and thus become more competitive in the local and Israeli markets. To bypass this problem, local firms had to hire an Israeli buyer in order to make the purchase on their behalf, thus adding to the cost of purchase.

This firm faced considerable difficulties in obtaining the secondhand dyeing machinery that it had located at an Israeli auction as a result of a coordinated effort on behalf of Israeli dyeing firms to prevent the purchase. This forced the local firm to hire an Israeli agent to make the

purchase on its behalf. The Israeli agent faced some difficulties, but was able to purchase the machinery despite all the opposition. The firm was not able to receive any technical assistance from the firm that sold the machinery and was forced to experiment with the machinery and at some point seek the help of the Israeli engineer. The secondhand machinery was inefficient and was only capable of producing 1 ton per day, but it was sufficient to cover the requirements of the firm especially during the slow down in production during the later years of the uprising.

During the period of the uprising, access to formal sources of machinery in Israel were accessible only to a limited number of local producers who had been able to maintain the required clearance papers allowing them to cross the border into Israel. Most other producers had to rely on the locally available supply of used machinery, or have continued making do with using their existing equipment. It became increasingly difficult for local firms to transport new machinery from Israeli sources through border crossings. Usually, the border officials will audit such firms, claiming that the introduction of new machinery could only be reflective of growth and an increase in their taxable income.

The deterioration of political conditions that led to a deterioration in communications between the local population and Israel, forced many Israeli machinery importers to suspend their deferred payment plans to local producers out of fear of being unable to collect. The Israeli agents began insisting that a full deposit be placed with them prior to their ordering the required machinery and before the establishment of the letter of credit. The suspension of most services by local branches of Israeli banks has forced local firms to pay the entire amount due in cash, requiring the availability of a high reserve of working capital and risking the confiscation of such cash amounts if checked by taxation officials at border crossings. Israeli import agents and maintenance engineers became unwilling to enter the occupied territories for the provision of maintenance services or initial instruction sessions on the newly purchased machinery.

Local producers have lost all access to benefits that could have been guaranteed if their direct access to the machinery producers was safeguarded through a direct import operation by the individual local firms or a local import agent. The commercial criteria that have in the past determined the character and stability of the relationship between those local firms and the Israeli agents have not provided these links with the required protection and stability that has become most needed during the years of the uprising. The Israeli importers did not feel any obligation to local producers despite the long and stable years of dealing that they might have

had with them in the past. Those agents came to be used by the taxation authorities to expose the economic dealings between them and specific local producers in an attempt by the authorities to extend their control over all economic activities by local producers.

5.5 LABOR:

The restrictions on the development of the industrial and agricultural sectors in the occupied territories and the limited employment opportunities in those sectors have resulted in a steady increase in the percentage of unemployment in both territories. The Israeli economy absorbed the surplus workers in the form of a migrant cheap labor force. In 1970, the number of officially registered Palestinians employed in Israel reached 20,000 (12% of the total local labor force) and had increased to 90,000 (36.5%) by 1985. Unofficial estimates which include undocumented workers have indicated that on the eve of the uprising, the number reached 125,000 (42% of the total local labor force).¹²⁷ However, during the uprising the number has declined considerably due to restrictions on the entry of Palestinians to Israel. The gulf war also resulted in further restrictions, reducing the number to less than 15,000. The current unemployment rate in the territories has soared during the last months, while local productive sectors have not been able to absorb more than their initial employment capacity which had declined significantly during the past few years.

The majority of the Palestinian workers employed in Israel were not registered with the official Israeli labor offices. They received very low daily wages and no work benefits. The registered workers also received lower wages than their Israeli counterparts and were not offered any job security guarantees from their employers or from the labor office.¹²⁸ None were able to collect unemployment pay once they were laid-off. None received any social security pay even though all taxes and social security percentages were automatically deducted from their pay. They all received inferior health insurance benefits and could not gain access to the better equipped medical facilities in Israel. All Palestinian workers are required to return to their territory of origin at the end of each day. None were allowed to rent housing in the Israeli cities. The workers who decided to remain and save in transportation costs had to sleep in their

¹²⁷ Shadid, "Israeli Policy Towards Economic Development," 126.

¹²⁸ Al-Dweik, "Self Selection and Spatial Mobility," 151.

work place, if the employer agreed, or stayed in an illegal low quality rental space.

During the initial stage of the occupation (1967-1969), the local economy was going through a transitional phase during which the local labor force saturated local employment opportunities and began spilling into the Israeli markets. subcontracting links with Israeli firms generated local sources of employment in the territories, but not enough to absorb the increasing surplus labor. A significant number of the locally educated and highly skilled workers departed to the Gulf states during this phase, in search of better employment opportunities in their booming economies. The labor force drain had a negative impact on the local productive sectors and the prospects for development. The skill level of the remaining labor force declined as restrictions on development increased.

During the initial phase, the majority of the local industrial laborers worked in small scale maintenance workshops, providing services for the low income segment of the local economy. Unlike the evolving subcontracting sector, the links between these types of production and maintenance activities and the modern sectors of the Israeli economy were not yet developed. The flow of local workers back into the local productive sectors was significant. The increase in subcontracting links with Israeli firms has resulted in an improvement in the quality of production of those particular firms, because of their exposure to new production techniques and new efficient production processes. However, those links have not transferred technical capabilities to the majority of the workers involved in such lines of production. These firms and their workers developed limited connections with the local economy and its productive sectors and have benefited the local economy as viable sources of employment but not of technical transfer or business for other subsectors.

7- The percentage of highly skilled workers has been higher at the tailoring branch than it has been at the subcontracting branch of the firm. The type of work done at the tailoring branch is more detailed and encompasses a wider range of operations, requiring a worker with a wider range of experience and flexibility in order to meet a variety of tasks. The work done at the subcontracting branch however, is based on an assembly line system of production, requiring limited knowledge about the entire operation by the involved workers.

The flow of Palestinian workers back to the other sectors of the local economy began during the second phase of the occupation period (1970-1982). At that point, Palestinian workers began returning to the local economy with the experiences and connections that they had been able to accumulate during their period of employment in Israel.

This reversed tide of experience and connections brought with it a number of new

production ideas which targeted local demand and, in many cases, operated in competition with Israeli producers in Israeli and local markets. The circulation of the workers also assisted local firms that were already established in their attempts to upgrade their production activities as well as in establishing links with new markets in Israel and new sources of raw materials and machinery. It also supported the establishment of new firms. The confinement of the Palestinian workers in Israel to lower tech jobs in industry maintained their technical skill at a relatively low level. However, the workers in this sector were able to benefit beyond the confines of their particular jobs in Israel by establishing informal contacts with more advanced production activities. They were also able to learn from their exposure to other activities within other sectors of the Israeli economy. This second phase of occupation was the period during which the local industrial sector underwent some level of growth in specific subsectors. Wages paid by local formal firms became comparable and, in some cases, exceeded wages received by Palestinian workers employed in Israel, while informal wages remained lower.

During the third phase of occupation in the mid-1980's, the specific subsectors of local industry became saturated and well developed. Entry of new firms became more difficult and required more aggressive and innovative marketing and production approaches by the newcomers in order to forge new market niches locally or in Israel. The involvement of new or existing firms with new subsectors that could present Israeli producers with a potential source of competition became much more aggressively obstructed. The increasing scarcity of local employment opportunities, as well as the ability of the Israeli economy, aided by military and administrative restrictions, to determine the pattern of growth in the local economy, has created a mismatch between the specialization of the workers and the jobs to which they are able to gain access. A very limited number of local workers have been able to gain access to employment in the field of their specialization or past experience especially if they were university graduates. Local workers have been forced to change specialization a number of times in order to fit within the requirements of the limited pattern of development, which is usually determined the specifications of the Israeli economy and by the response of the local economy to them.

The uprising brought with it new conditions for the Palestinian labor force. Local work opportunities declined even further as a result of the decline in the level of production of many local firms. These declines were the result of a drop in the average income of the local

consumers and the escalation in disturbances and restrictive retaliatory measures. Most firms significantly reduced the number of workers they employed, and began to rely more heavily on family workers. The reductions were mainly from the lower skilled segment of the firm's labor force, while the higher skilled workers were not dismissed. Job opportunities in Israel decreased considerably as a result of restrictions on the mobility of the local workers and the increasing competition for previously held jobs with newly arriving Soviet immigrants. Wages dropped to a record low because of the decline in work hours, but most employers attempted to absorb a higher percentage of this decline in the hope that its core labor force could afford to remain and not seek better employment opportunities in Israel or outside.

4- The decline in the number external wage laborers during the years of the uprising brought about an increase in the number of family workers with responsibilities expanding to maintenance, administration and delivery of raw materials and finished goods. Most highly skilled workers remained with the firm and the reduction occurred among the lower skilled and maintenance workers, drivers and guards. The average wage of external workers who remained was reduced but the decline was not reflective of the slow-down in production and sales during the uprising. This was done to help workers who remained to be able to afford to stay with the firm and not be forced to seek better pay through employment in Israel or in neighboring Arab countries.

Women have faced many difficulties in gaining access to local industrial employment due to social barriers. They have obtained jobs in light industries such as sewing and other hand crafts production, especially if only female workers were employed by the firms. If men had to be employed by the same firms, there had to be a physical separation between the two sexes. It has been easier for some local women to take to industrial jobs with Israeli firms because of their anonymity among workers and the distance from local communities that might be critical of the type of work that they are engaged in or the type of people with whom they are working.¹²⁹

During the uprising, women have generally been playing increasingly active roles and these conditions began to change. The rise in the number of men imprisoned by the Israeli authorities during the years of the uprising (20,000-40,000) left many households without their traditional breadwinners. This forced many women to get involved in various types of income generation activities within the household and in the external economy. The increased harassment of men by the security forces made it more difficult for them to maintain the

¹²⁹ It is traditionally thought of as shameful in traditional local communities for a family to allow women to seek external employment, even if the family is facing financial hardships.

necessary mobility and has led to the increased reliance on women for tasks that require dealings or confrontations with Israeli security officials, who are sometimes less likely to harass women.¹³⁰

However, the increased engagement of women in the various economic and social activities has been thwarted to some extent by the rise and the increasing strength of the Islamic fundamentalist movements in the Strip during the later years of the uprising. However, these Islamic trends have not been able to completely reverse the tide of increased women's involvement, because communities have realized that the needed work could otherwise never be done.

Even though a significant percentage of local firms have had to maintain a formal status with the taxation and industrial registration departments, very few maintain formal relations with their wage labor force. The majority of local firms will not sign a formal contract with their external employees, but will provide a selected core of highly skilled and deeply trusted workers with informal assurances of their intention to continue their employment. This selected group will usually earn better wages, be guaranteed better benefits and expect employment opportunities for their relatives or dependents in the future. In many cases, these employees will remain with the firm for the duration of their working career.

2- The highly skilled workers were more committed to the firm as was the firm to them and were thus paid higher wages and their position with the firm informally guaranteed. All of the highly skilled production workers have remained with the firm. Lower skilled workers tended to come and go depending on their ability to obtain better pay either locally or in Israel. The firm did not exert real effort to keep those workers.

The instability of the economic and political conditions in the territories and the flexibility that those conditions require has resulted in the willingness of firms to abandon a large segment of their labor force if conditions press them to do so. The workers often adopt this approach as well, remaining mobile, in search of better paying and eventually more stable work opportunities. Such opportunities are not found through employment in Israel. For this reason, Israel has offered a suitable market for mobile and flexible workers and for others who have limited employment opportunities within the territories. Local firms can offer these types of work opportunities but only to very small percentage of the local labor force. The majority

¹³⁰(this is not a rule. Many women have been beaten and imprisoned by Israeli security officers during their attempts to sell their household products in the open markets of the cities and neighborhoods or as a result of their increased involvement in the community action groups.

do not last in one job for much longer than a year or two.

To limit cost and to maintain control over production activities and production secrets, many local firms have gone into business using only family labor. These firms then might expand their external wage labor force after they have guaranteed market share and a stable production process. The family labor will always maintain control over administration and high skill positions and will confine external wage workers to inferior positions in production and exclude them from administration positions. The inability of family members to fill all the important positions and the difficulty of maintaining a supply of appropriately trained family workers have sometimes forced firms to allow external workers to gain access to such positions. However, in these cases the firm will always attempt to maintain a technical edge among family employees over the highly skilled external work force.

I - At the initial stages of the firm's establishment, the partnership's extended families provided most of the labor force. This was done to reduce the risk that the firm might face during its initial years, until a stable market was guaranteed. The advanced age of most of the working partners eventually posed some problems with this approach, but control over all administrative positions and the most senior production responsibilities was always maintained. The firm began introducing external wage workers gradually and relied on local workers with experience in textiles production which they had obtained through employment with Israeli firms during the initial phase of occupation. The rest were trained in-house.

The need of firms to rely on external wage workers for the supply of a significant portion of the highly skilled labor force has also forced some firms to allow more control of the production activities to be transferred to a core of highly trusted skilled workers. The firm usually establishes more stable relations and extends a considerable level of informal commitment to this core of employees which is expected to share the same level of commitment to the firm. Lower skilled wage workers are usually mobile and are expected to move elsewhere if the pay and work conditions are more attractive. The firm is usually much less committed to those workers with the exception of a few who manage to gradually become part of the core group of trusted external employees.

The inability or resistance of local firms to give external workers influential positions within the firm structure in production or administration limits the future ability of firms to develop efficiently by utilizing external sources of talent and capabilities. Firms have thus been confined to the technical and administrative capabilities of the owners that are in most cases limited.

Local firms have also been unwilling to invest in the development of the capabilities of their external workers out of fear that those workers will abandon the firm after having obtained their training, seeking better employment opportunities. Family workers have had limited opportunity to develop their own capabilities through formal technical or administrative training programs, due to the extensive scope of responsibilities they are required to handle during their work with the firm which allows very little time for such activities.

6- The firm has not independently ventured in developing the technical skill of its labor force through formal technical training programs because it felt it would only be willing to invest in members of the extended family and not external workers. The need to have the members of the extended family always present at the production plant prevented them from joining any formal technical training programs which could be offered by machinery producing companies abroad. The firm's unwillingness to invest in the formal training of external workers stems from their fear that such workers would leave the firm after receiving their training if they received a better offer from another local or Israeli firm or would eventually establish their own independent firm. The type of contract with the external workers does not commit the worker to the firm for any specified period of time, nor does it commit the firm to the employee for any specific period of time or the provision of long term securities or benefits.

The main source of technical instruction and training for the majority of the local labor force has been through informal job training and not through sources of formal technical training programs. Local branches providing programs, such as the UNRWA Technical Schools, have been too limited to cover the local need for technical training and upgrading of the capabilities of the labor force. As I have mentioned in the previous section, the restrictions on the development of the local productive sectors have continuously led to the drain of the highly skilled workers and professionals who receive their training independently, through external and local programs with higher education and technical training institutions. This occurs because the local pattern of development has not been sufficient enough in its scope to provide an opportunity for graduates of such programs, leaving them with no option but to seek opportunities in the unrestricted economies of surrounding Arab or foreign countries. Because there has not been a concerted matching of skill building with the requirements of the local economy, the labor force which has emerged is unspecialized and low skilled.

Local firms have not independently attempted to gain access to formal training programs offered through external producers of machinery or Israeli import agents with whom they have had extensive commercial relations. The majority opted for the informal methods of trial-and-error in exploring the capabilities and technical specifications of their machinery. Even though many local firms have worked very hard to develop their in-house maintenance

capabilities to reduce cost, very few have made full use of the technical assistance services offered by agents or the producers of the machinery. Therefore, many firms have not made the most of the modern machinery and have continued to rely on services provided by formally trained Israeli engineers for most of the more complex maintenance operations. In-house and local maintenance crews have been able to handle a significant portion of the required maintenance operations, but have been paralyzed when they had to deal with the more complicated procedures.

3- 80% of all maintenance operations are carried out in-house by a maintenance team and other highly skilled workers. The complicated maintenance operations, especially mechanical failure of the machinery, are usually done by an Israeli engineer, whose consultation is kept at a minimum due the high fees he charges for such special visits to the firm. Most other electrical or electronic problems are dealt with by local maintenance specialist in the city of Gaza.

5.6 LOCATION:

While the majority of local firms relied for their existence on their ability to sell their products in Israeli markets and to acquire their machinery, equipment and technical know-how from or through Israeli sources, they were obviously forced to limit their location decisions to sites within the two territories. The mobility of the Palestinian inhabitants between the two territories was restricted. The inhabitants were banned from relocating from one territory to the other. The same limitations on the mobility of individuals applied to firms. A firm could only be established in the territory of residence of the owner, unless a partnership was established with inhabitants who reside within the other territory. However, most local firms are owned by single extended families and are not based on partnerships, so they are limited by this regulation.

During the initial 20 years of occupation (1967-1987), a pattern of firm location evolved in the two territories reflecting the limitations imposed on the functioning of manufacturing firms and the relationship they were able to develop with local or Israeli markets. I will identify two categories of firms in both territories and then discuss the criteria that seem to be important in determining location decisions.

Firms Dependent on Israeli and Local Market Links and Israeli Supply Links:

The inability of these firms to locate closer to Israeli markets and/or sources of raw

materials and technical transfer forced them to develop location criteria based on their relationship with the local economy and its sectors. Distance between the firm and its target markets and input sources and the subsequent cost of transportation of its products and inputs had to be considered as a fixed cost unless a firm was able to locate closer to the border with Israel. The possibility of doing this was limited because of restrictions by the Israeli authorities. The location criteria used by this category of firms were therefore shaped by the links that a firm had to develop with the local economy and in most cases did not incorporate distance from target markets and sources of inputs. The aspects that had to be considered are summarized below:

- a- The proximity of a firm's location to suitable municipal source of power and services.
- b- Proximity to a main central transportation artery with direct access to the regional highway system connecting a given town within the Palestinian territories to Israel.¹³¹
- c- Proximity to other local firms with which subcontracting relations were established.¹³²
- e- Availability of large land parcels on the periphery of cities became important as the size of some firms increased and the ability of a firm to acquire the necessary building permits from the municipality and the Israeli department of trade and industry. Many firms that had initially located in or close to central mixed use districts of towns and cities had to relocate as a result of objections by the surrounding residents or a refusal of permits by the authorities. This was more frequently the case with larger-scale polluting production activities. Production activities that produced relatively low pollution levels did not face this problem.
- d- Accessibility of the firm to its labor force was usually not an important criteria because the local labor force has become accustomed to long distance travel seeking employment in Israel and found trips within the territories to be relatively manageable as long as the firm was located on main transportation arteries that were accessible by local modes of transport.

1- The initial location of the factory was in a residential/commercial area of the city of Gaza. As production increased, the factory was relocated to a larger parcel of land in a peripheral mixed-use location along one of the main entry corridors into the Gaza Strip. The land was leased from the Department of Islamic Endowment on a renewable three year basis at the rent of \$1,000 for the entire three year period .

¹³¹ this was a high priority for firms producing heavy products and requiring heavy raw materials.

¹³² Firms manufacturing basic metal products, had to subcontract-out part of their production activity to local machine shops.

The location criteria cited above led to the formation of firm clusters linked to one another through subcontracting relationships and located along main transportation arteries close to other clusters of small scale machine shops. Those areas became unofficially designated as informal industrial districts, usually located along the entrance of local towns and cities with links along the central city spine to commercial and other light industrial districts.

However, some firms within this category used a different location criteria which was based on saving rent money by locating within owner's residential property. For these firms, other location criteria played a less important role, at least for household production firms, small-scale limited capital investment firms and firms with limited links with the local economy and its productive sectors. Such firms took into consideration the cost of the production space they used as one of the most important factors in deciding location.¹³³ They were thus scattered in various locations within the lower income and traditional areas of towns and refugee camps.

6- The initial operation was located in a central commercial district in the city of Gaza. In 1982, the operation was relocated to the space underneath the owner's residence in a residential neighborhood in search of additional space. The move of the operation to a residential neighborhood was not problematic because the type of activity did not create a conflict with residential activities. The new location came in handy during the uprising when curfews and strikes became a weekly occurrence. The presence of the workers in the vicinity of the house was not problematic. The house is spacious and the separation between the house and the work space is sufficient.

Firms with Links to Local Markets and Israeli Supply Links:

The firms in this category had to give a great deal of attention to their proximity to local markets and local sources of raw materials.¹³⁴ Since their targeted market was limited to the local population, the firms within this category remained considerably smaller than firms that were able to develop extensive links with Israeli markets. Therefore, locally oriented firms had to maintain flexibility, reducing or expanding the scale of their production activity in response to fluctuations in local demand. Their capital investments in machinery and physical structures had to be kept at a minimum.

As a result of these limitations, some firms located in residential neighborhoods within structures already constructed for the owner's family residence. In other cases, they occupied the commercial units included in most extended family structures on important streets within residential areas. The location pattern of these types of firms created a neighborhood character

¹³³ Particularly sewing workshops with subcontracting links to Israeli firms.

¹³⁴ Those are local agents of Israeli produced or imported raw materials.

that resembled the traditional pattern found in old cities or other cities in developing countries, where certain residential or mixed-use neighborhoods became associated with the production of certain goods or the sale of certain commodities.

The limited size of the market available to such small producers limited the growth of this sector, while the availability of employment in Israel played an important role in absorbing the local labor force that would have otherwise been involved in such production activities. Employment in Israel and the daily labor migration from local towns and cities began to gradually transform some neighborhoods into dormitory towns with minimal income generating activities taking place in them during the day. This phenomenon was most noticeable in the refugee camps of the two territories due to the high unemployment rate of their inhabitants and the strict zoning restrictions banning the construction of permanent structures, the introduction of non-residential functions into the camps and placing limits on parcel size. As a result of such restrictions, the spread of income generating activities in the camps was basically linked to retail business rather than production.

Shifts in Firm Location Criteria During the Uprising:

The conditions brought about by the uprising altered the criteria used by local producers in deciding firm location. The production activity carried out by firms in the occupied territories became more oriented towards local consumption. Firms that previously relied on Israeli links developed new local ones and gradually became more independent of Israel. While Israeli markets replaced to some extent by access to local markets, no alternative source of raw material was found, except for a limited supply provided by local merchants. The increased difficulty of movement between the territories and Israel made access to required raw materials highly vulnerable. The inability of local firms to reduce their vulnerability to this factor by altering their location decision made this factor and the difficulties it represents come to be considered as a constant or fixed cost for all firms wherever they might be located within the territories, unless they relied on a local agent or merchant of raw materials for acquiring their needed supplies.

Previously established informal industrial districts became easy targets to taxation and product confiscation raids by the authorities. The majority of local firms relocated, most of them to residential districts. Many firms relocated to the owner's neighborhood and utilized

already existing or added space within the family residential structure. The reasons behind this relocation decision could be summarized as follows:

- To avoid work stoppage during general strikes and curfews by utilizing idle family labor.
- To avoid taxation and product confiscation raids. It is more difficult for taxation officials and army units to venture into high-density residential neighborhoods and if they did, residents of the neighborhood could inform the factory owners of army movements prior to their arrival at the production site, enabling them to close shop or hide unused inputs and finished products.
- To save on payments for rental facilities.

2- At the advent of the uprising, the firm established a branch production plant in the land parcel surrounding the residence of one of the partner extended families, located in a Gaza residential zone. The decision was made in an attempt to reduce the impact of strikes and curfews on the production operation. During regular days, access to the main plant became increasingly unpredictable due to the scattered demonstrations and disturbances in the neighborhoods surrounding the main plant. With its location on one of the main Gaza Strip traffic arteries, the main plant became more exposed to increased raids by taxation officials supported by army units. The new location was suitable for the members of the extended family who lived on the premises but not suitable for the external workers who had to commute from different parts of the city and mainly from the neighborhoods surrounding the main plant. Recently, this new branch began employing workers from the surrounding residential area.

For firms not limited to relocating to the owner's neighborhood, the following criteria were considered:

- The availability of a suitable labor force within a given neighborhood.
- The presence of other firms and workshops providing goods and services necessary for the functioning of the relocating firm.
- The availability of a local source of raw materials (i.e a local raw material agent or a source of used machinery and other recycled supplies).
- Neighborhoods considered hostile to army presence were selected to guarantee a minimum occurrence of sudden taxation raids.
- The place of residence of a firm's owner became the prime target of taxation raids by the authorities during the years of the uprising. This forced owners to select a residential area different from their own and therefore less likely to be targeted by such taxation raids for informal production activities.

As a result of the increasing pressure on this firm, it was forced to stop production in the main shop which was located in mixed use area of the city, and relocated to a new rented property away from the center of town and the area of residence of the owner, in an attempt to

escape from the now regular taxation raids. The old shop still has all the machinery in it. It was closed in June 1988. After the closure of the main shop, it was raided by the authorities and most of its remaining machinery was confiscated even though they were informed of the stoppage of the production activity. The authorities were not informed about the new shop. The raids on the old shop were to collect taxes on the assumption that the main shop was still involved in production. The new shop was established in October 1988, and has not been registered with the taxation department, municipality nor the department of Trade and Industry. The firm has not had any more raids by the authorities after the relocation, but the authorities are still asking the firm to finalize its closure of the old shop and make the final payments to close its taxation account. All the production taking place in the new shop is unreported and the firm has no intention of registering the new shop because they feel that they will be overtaxed even if they make all the due payments.

The relocation of most firms to the owner's neighborhood resulted in mixing of different production activities within residential neighborhoods. In such situations, no logical firm location pattern has yet developed. Firms producing different products and requiring different inputs located within the same neighborhood have not been able to coordinate their activities and therefore have been unable to establish efficient links with one another. Such relocation decisions have been influenced solely by the existing residential location of the family. The functional requirements of the firm have not been taken into consideration at this stage. To alter this outcome, residential location preferences and the functional location requirements for a firm will have to be coordinated. This process will require a long period to adjust the lag which is present between residential and functional production requirements. In situations where firm owners selected residential areas other than their own for firm location in an attempt to address the production activity, location requirements have contributed to reducing the lag present between residential and production location preference.

9- The new plant is located in the commercial floors of a residential building. The space is rented. The location was selected for its closeness to the source of labor and its distance from competitors who could come by to steal ideas and methods of production. The area that we are located in is in a mixed use zone that has housing and a concentration of industrial activities that have selected the location to be away from the taxation authorities.

During the coming few years, if the situation in the occupied areas is not decisively resolved through a peaceful negotiated settlement, and if the current conditions persist, more clustering of related production activities would have to take place. Populations might not relocate within each city at the same pace as firms will, but neighborhoods will gradually become increasingly identified with certain production activities. The specialization of a given neighborhood will have to be based on that neighborhood's attributes and its comparative

advantage in the production of a certain commodity. This pattern of firm relocation within, or on the periphery of, residential neighborhoods will recreate and reinforce the traditional pattern of mixed use neighborhoods found in most cities of the developing world, enhancing a neighborhood's economic base and source of local employment.

The relocation of firms to residential neighborhoods introduced a series of positive economic factors that are essential to a process of economic disengagement from the Israeli economy and a subsequent rebuilding of the local Palestinian economy. At the same time, it has introduced a set of social and physical tensions to the residential areas.

3- There are many drawbacks to the new location that affected the production activity, employees and extended family members involved in the operation. The physical introduction of the production activity into the residential space of the extended family, gave it a layer of importance amongst uninvolved family members that it did not have when it was located in the main plant. In addition to the noise of the machinery and the other byproducts of the production activity, it became the central attraction for the entire household diverting attention from previously important residential and social activities. The working hours for family laborers became greatly extended, occupying most of their free time during the night and weekends. The existence of the plant at the family residence made the flow of customers unpredictable, and became unlimited to work hours. Other drawbacks to location in residential area:

- The increase in the distance from main roads and distribution routes within the Strip resulted in an increase in transportation costs.

- The limited space available for storage and production activities forced this plant to utilize storage facilities located at the main plant, adding additional transport cost.

- The electrical current provided in the residential area is not suitable for heavy machinery. Its fluctuation and low power has resulted in the destruction of a number of electrical motors that drive the textile weaving machinery. The current reaching the main plant was provided directly from regional Israeli power generators and did not pass through the municipal redistribution station. The direct link meant lower power prices and a constant 400 volt electric supply, 24 a day. More power failures occurred in residential zones due to the decaying conditions of the municipal electric redistribution system.

5- The location of the firm within the extended family residential structure has its positive and negative aspects. The first draw back of locating under the place of residence is the inability of house hold members to make a distinction between the work space and the living space. The family members working at the firm will always be required to run errands for members of the household. The presence of the factory underneath the house or close to it allows clients to assume that the household and the work place are one and the same and would therefore stop by the household for business transactions during closing or rest hours, making the life of all family members and particularly the owner or the persons working at the firm occupied with work continuously.

The presence of the firm near the house has many positive attributes as well. The owner will always be in close proximity to the place of residence and his family during times violent unrest. The presence of the factory near the house or below it provides a physical barrier between the household and the external unsafe environment. The young children have a place to play in under some supervision from the workers and their father. The presence of the firm under the house is particularly suitable during the days of the uprising when strikes

and curfews are a weekly occurrence. The firm's owner has the chance to carry on with some work during those interruptions. The presence of the workers in the vicinity of the household does not represent much of an inconvenience. Most of them are isolated from the residences and spend most of their time in the firm's production space, and depart at 3:30 pm daily. The location is sufficient for further expansion in the future. There is no intention to relocate if conditions improve.

The economic importance of the firms to their owners and to the local inhabitants resulted in their intrusion into residential and semi-private neighborhood spaces. Since the firms were flexible in character and needed to respond to fluctuating demands, they sometimes expanded outside their designated space, in some cases taking over the entire area of residence in the more dense areas and spilling over into the surrounding public spaces, further disrupting other activities. Social patterns prevailing in these neighborhoods were disrupted by the presence of groups of workers, the majority of whom come from other neighborhoods. Environmental pollution problems created by the newly introduced manufacturing activities represent a more challenging situation. It is further exacerbated by the lack of appropriate infrastructural systems in residential areas suitable for serving such manufacturing activities.

The coexistence of residential and income-generating activities in the neighborhoods of Palestinian cities and towns seems to be a necessity during this transitional period. It is essential that the on-going and future processes of physical, social and economic restructuring, which are now being carried out privately by individual residents accommodate these evolving patterns. The spatial organization of these neighborhoods must be reorganized in order to reduce the tension between the various activities. The rate of flow, quantity, and scale of raw materials and outputs to and from firms, as well as the type of infrastructural support system required by them, will dictate their ultimate location within the neighborhood. A process of selection based on the nature of the production activity could be employed to gradually relocate large-scale and environmentally hazardous production activities to external locations. The relationship of the production plant to the residential unit could be modified further when such firms become better established and financially capable of reducing the intrusion of production activities on the place of residence.

4- The relocation of all production machinery to structures physically detached from the residential structure, reduced the vibration and noise that would have otherwise found its way to the residential portion of the structure. The addition of a series of industrial structures to house the production activities, created a suitable separation between production and residence. The ground floor of the residential structure was used for administrative functions and storage which created a buffer between the two other activities. The residential structure maintained an independent entrance, separate from that used by the production activity. An

elaborate circulation system was introduced between the residential structure and the production plant which allowed safe and unexposed movement of family workers during military curfews.

With further development during a more positive political settlement, this pattern could provide a base for a series of economically viable neighborhoods, contributing to an integrated city or town-wide system of production and equitable resource distribution.

VI SUMMARY OF FINDINGS:

- 6.1- The Making of the Regulatory Framework.
- 6.2- Relationship of Firms to Regulatory Framework.
- 6.3- Mass Production vs. Flexible Specialization:

6.1 THE MAKING OF THE REGULATORY FRAMEWORK:

During the initial phases of occupation, the military authorities installed a system of control over all aspects of life in the occupied territories.¹³⁵ It was shaped by the interests of the occupying power and the requirements of the Israeli economy. The evolving economic activities within the two territories had to abide by this system in order to avoid conflict with and obstruction by the authorities. What distinguishes this system from other authoritarian oppressive and even military regimes is its consistency and its wide scope of implementation of macro-level policies. The occupation authority quickly installed a regulatory framework which was implemented by departments at all levels of both military and civil government. Furthermore, elements from the Israeli economic sector collaborated with the government departments as components of the regulatory framework.

The military government was put in charge of introducing, amending and implementing the laws governing all aspects of life in the territories, including the character of the relationship that the newly occupied territories were to have with the occupying state and its economy. It controlled all banking activities, the transfer of funds from external sources and allocation decisions of local and international funding agencies. The military government also controlled the provision of licenses for all productive projects in the territories, through which it monitored their development. Mobility of the population to Israel and the outside world was also subject to the supervision of the military authorities. They also took full control over allocation of land and water resources, which allowed the unchecked confiscation of both resources by these authorities.

The Civil Administration, introduced in the 1980's through the Camp David Agreement, took over many of the functions which had previously been carried out by departments of the military government. Temporary emergency laws, which had been introduced by the military authorities, were transformed into permanent laws under the civil administration. Ultimately, however the civil administration still remained under the control of the military authorities. Even in areas of jurisdiction which were formally transferred to departments of the civil administration, the military government interjected new rulings and amendments. Basically, the civil administration operated as an appendage of the military

¹³⁵ Israel did not recognize the status of the territories as "occupied", and therefore bypassed the Geneva Convention's stipulations applicable to militarily occupied territories and the treatment of their populations.

government with the same objectives. The local municipal councils came under the control of both the military and the civil administration. The input of local officials was marginalized and their interaction with the local population was extensively supervised by Israeli officials at all levels. Thus, they could neither contribute in the decision-making process, nor operate freely in any area of implementation.

The departments of taxation and customs also played a vital role within the regulatory framework. Their job was to extract revenues from economic activities taking place within the territories and between the territories and Israel. Even if the taxation of the occupied population were legal, the collaboration between these departments and the military created a criminally oppressive system of control over the population. The military backed up tax collection efforts with armed raids on production and retail activities, while the taxation departments intensified taxation clearance procedures complementing the military's "iron-fist" policies and on-going harassment of the local population. This cooperation obstructed the development of specific subsectors in the local economy and maintained the vulnerability of others which were permitted to function. The Israeli government allocated the large majority of revenues collected by these methods to the requirements of the military administration in the territories, and for use within the Israeli state. Only a very limited portion of the funds collected from the local population in taxes and custom dues was used for services for the local population. Furthermore, the customs department and Israeli port authorities, by progressively increasing the harassment of the Palestinian producers or importers and by intensifying the bureaucratic procedures at all port facilities, effectively eliminated the direct links between the local agents and external sources of raw materials, machinery and technological transfer. Instead, these links came to be fully controlled by Israeli agents.

However, the components of the regulatory framework were not limited to official government agencies and departments. Israeli firms, import agents and providers of commercial services formed a critical segment of the regulatory framework. Israeli firms contributed to the regulation in the following ways:

- by directing development through subcontracting relationships, and limiting links to local economy. (benefit: cheap labor and production processes)
- by working in direct coordination with government departments (including military) to obstruct the progress of competitive local firms by denying licenses,

permits and technical certification. (benefit: elimination or weakening of competition in local and Israeli markets.)

- by discouraging suppliers of raw materials and machinery from dealing with local producers, by independently pressuring local and Israeli retailers not to market locally produced goods, and by disseminating damaging disinformation about competitor's products to Israeli consumers.

- by reporting economic activities of Palestinian competitors to taxation authorities.

Israeli agents have obstructed the creation of direct links between local firms and external sources of machinery, raw materials and technical transfer. Because of their intermediation, the possibility for local firms to gain access to sources of extended payment plans was also denied. Israeli providers of essential production services for local firms have always placed their Israeli customers ahead of local firms. They have also taken advantage of local firms once they were aware of their monopoly on services in Israel and the territories.

Political ideology, territorial ambitions and the economic interest of the occupying state were used as the main criteria for the formulation of the regulatory framework which shaped economic, social and political trends in the occupied territories.

Stage I: Creating Connections Between the Economies of Israel and the Territories:

The first stage of the regulatory framework falls roughly between 1967 and 1973. During this period, Israeli authorities tolerated the development of economic activities locally and between the territories and Israel which did not conflict with the policies of the regulatory framework and did not compete directly with Israeli producers. Direct connections were created between the two economies in the areas of trade, employment, and subcontracting. Secondary connections developed between the two economies in the supply of raw materials, machinery, technology transfer and services by some independent firms through formal channels. Furthermore, at this stage, the restrictions posed by the regulatory framework were not so thorough that they prevented the development of informal economic activities and links with the Israeli economy.

The regulatory framework facilitated the development of one-sided trade relations

between Israel and the territories during the initial stages of occupation. The markets of the territories, which had become isolated from their traditional trade links, were transformed into dumping grounds for Israeli consumer goods and secondhand capital goods. However, the products of the territories, whether agricultural or industrial, as well as services provided by local firms, were denied access to the Israeli market unless the transfer of such goods and services complied with the guidelines of the regulatory framework.¹³⁶

Within the regulatory framework, the Israeli economy gradually absorbed a portion of the labor force of the two territories for direct employment in a few specific subsectors. This surplus labor force was available in increasing numbers because of the overall restrictions on the development of the local economy. This labor force was confined to jobs within the services, construction, agricultural and low-tech segments of the industrial sector, preventing any significant transfer of technical skill back to the territories. The absorption of this labor force functioned as a tool for the pacification of this segment of the local population without resulting in the development of viable economic activities within the territories. Forty percent of the pay of officially registered workers employed in Israel was deducted in taxes. Such taxes were considered to be funds generated in Israel and thus were not transferred for use in the territories. Workers spent a significant portion of their remaining pay on daily transportation fees and on household supplies in Israel, since most workers left the territories before shops there opened and returned after they closed.

Within the regulatory framework, Israeli parent firms established subcontracting relations with local production shops in a few subsectors (mainly in clothing). These services involved simple assembly operations that required little technology transfer and limited development of skills. The Israeli firms maintained full control over the cost of the services provided because of limited opportunity present for a large number of local competing firms. Since the regulatory framework did not provide any measures for the protection of the local labor force, whether employed in Israel or the territories, Israeli and local firms were able to sweat the local workers. Because the possibilities for development of other subsectors of the local economy were limited, local employment opportunities were likewise limited. This led to the expansion of employment in this category to 42% of the the locally employed labor force by

¹³⁶ Citrus packing for sale to or marketing through Agrexco , crafts exported by Israeli agents.

1987.

The regulatory framework also allowed the development of local firms in some subsectors, if they did not pose a significant source of competition for Israeli producers in both local and Israeli markets. The large majority of these firms were established by the elite and merchant classes of the territories in traditional subsectors that had existed prior to the occupation. These production activities were forced to establish new links with external sources of raw materials, machinery and technology transfer in Israel or through Israeli port facilities. Some of these firms that are located in the West Bank were able to continue their links with Jordan as part of the “open bridges policy” which was aimed at providing a limited outlet for surviving production activities with its traditional markets and thus absorb some of the frustration of the Palestinian merchant classes, in an attempt to gain their cooperation. These firms functioned within the regulatory framework and maintained a formal status, relying on the components of the framework for the smooth operation of its transactions.

During this early stage, some informal economic activities began to evolve which bypassed the regulatory framework altogether. The relatively unrestricted mobility of the entrepreneurs engaged in these informal activities within Israel allowed them to gain exposure to that economy and the production activities taking place within it. These firms also capitalized on the knowledge accumulated and links established by the Israeli employed local workers with the productive sectors of the Israeli economy. The influx of secondhand durable goods and used machinery from Israel to the markets of the territories provided these firms with ample opportunity for experimentation through maintenance operations, while it allowed others to use the low-cost machinery for the establishment of small-scale production workshops. The increased income of the working classes within the territories through their employment in Israel gave a boost for the consumption of the goods and services provided by these informal activities. These firms limited their functions to the low-income local economy and created links with informal sectors in Israel. Their unwillingness and inability to function within the formal regulatory framework provided them with a freedom of exploration, a deeper understanding of trends within the local economy and a more vigorous exploration of possibilities within the Israeli economy.

Stage II: Restrictions by the Regulatory Framework:

The second stage of the regulatory framework falls roughly between 1974 and 1987. This period witnessed a series of shifts in Israeli policy towards the occupied territories which resulted in the increased scope of the regulatory framework and decreased tolerance of economic activities within it. A more aggressive campaign was launched with the aim of expanding the applicability of the regulatory framework to include informal as well as the previously formal economic activities that had been taking place within the territories and between them and Israel. The ability of informal activities to continue outside this framework became increasingly limited after their freedom of mobility between the territories and Israel became conditional on their formal status.

Local manufacturing firms that functioned within the regulatory framework during the initial stage began facing increased pressure from components of the governmental segment of the regulatory framework, pushing them towards increased reliance on Israeli economic sectors for the acquisition of basic services. Increased security and customs procedures at port facilities left local importers no choice but to resort to Israeli import agents in order to bypass such complications. The disruption of their direct links with external export sources led to the disruption of their links to sources of technology transfer and deferred payment plans and transferred such benefits to the Israeli agents. Their inability to conduct their own import procedures denied them access to local bank import credit facilities. The complete exposure of their economic transactions through their activities with Israeli banks and formal suppliers of raw materials and machinery left them easy prey to the departments of taxation, as tax rates were increased and new taxes were introduced illegally. In some cases, tax estimates for the year's economic activity that took place prior to the introduction of a new tax law were collected. Even though these firms functioned within the regulatory framework and abided by its guidelines, they found themselves with no legal recourse against injustices committed by the various components of this framework. This stage began to expose the vulnerability of firms that existed and evolved within this framework. Their ability to function outside it proved to be a difficult task, while remaining within it grew increasingly untenable.

During this stage, Israeli firms, importers and producers of materials and machinery and providers of services, began playing an increasing role within the regulatory framework. As the ability of local firms to compete with Israeli producers was developed during the first stage even when they functioned within the regulatory framework, their confrontations became

more frequent.¹³⁷ Ideological factors began to replace commercial ones in the relationship between local and Israeli firms. The deterioration of the political situation and the intensification of the negative campaign by certain Israeli political parties and branches of government contributed to the deterioration of relations and the politicization of previous commercial links.

During this stage, previously unsupervised local informal economic activities became intensely monitored by various components of the regulatory framework. Increasingly, these firms were unable to gain access to Israeli economic sectors through the border crossings unless they maintained a formal status and registered with the taxation departments. Local informal suppliers of raw materials, second-hand machinery and durable goods obtained in Israel faced the same border problems. The unwillingness or inability of informal firms to abide by the new regulations and function within the modified regulatory framework resulted in their confinement to an increasingly limited local economy and the loss of access to all formal and informal sectors of the Israeli economy.

Although the forced formalization of informal activities created insurmountable difficulties for a number of these firms, the more established and financially capable ones were able to make the transition, and in some cases benefited. Their extensive experience with the local market and their links within Israel allowed these firms to live with the regulatory framework and bypass it whenever they were able to do so.

Stage III: Obstruction by the Regulatory Framework:

This stage of the regulatory framework began with eruption of the Palestinian uprising and is still in effect. After having forced most local firms and other income generating activities to function within the regulatory framework, the execution of harsher policies became easier.

During this stage, tax collection procedures were intensified and tax estimations became less related to the actual performance of local economic activities but rather based on the whims of tax officials. The military authorities began providing assistance to tax collection officials during taxation raids, while all border check points between Israel and the territories functioned as fool-proof surveillance points for all individuals crossing into Israel or between the territories. Additional individual surveillance procedures were added with the introduction of the Magnetic ID Card which was connected to the tax, security and municipal payment records

¹³⁷ see role of Israeli firms, agents and providers of services in chapter four section 4.3.

of each individual engaged in economic activities in or outside the territories.

Car registrations and license plates for all vehicles in the Gaza Strip were ordered to be changed. License plates with a slightly different design and color tint were provided with a compulsory payment of an average fee equivalent to \$700 for each vehicle. During this process, all motor vehicle owners were forced to pay other unpaid fines to government departments and register with the taxation departments if unregistered. Personal ID cards were also changed to a different color with a compulsory payment of yet another fine and a further formalization of individual status, increasing their entanglement with components of a modified regulatory framework.

All services rendered by branches of Israeli banks in the territories were suspended and these branches relocated to points outside Palestinian cities. The only banking services that remained were offered by branches of Arab banks which continued to function under the control of the military authorities and were denied transactions between Israel and the territories and between the territories and the world. Most Israeli suppliers of raw materials and machinery suspended their issuance of extended payment plans to local firms and began insisting on cash on-the-spot payments on all transactions. Israeli retailers and consumers engaged in the boycott of Palestinian goods that were able to reach their markets in retaliation for the boycott of Israeli products by the local population during the years of the uprising.

This stage made functioning within the regulatory framework almost impossible while making functioning outside of it even more difficult and extremely limiting. The ability of firms to continue hinged on their guaranteeing a stable niche in local markets despite the declines in consumption by the local population. For the most part, only the producers of basic goods survived, but they were forced to function within the increasingly restrictive regulatory framework to maintain their access to Israeli formal suppliers of raw materials and machinery. Others firms, which were unable to continue functioning within the regulatory framework due to excessive taxation payments and increasingly complicated bureaucratic procedures, were confined to a limited local market and the even more limited local suppliers of materials and machinery.

6.2 RELATIONSHIPS OF FIRMS TO REGULATORY FRAMEWORK:

Impact on Firm Structure.

FUNCTIONING WITHIN THE REGULATORY FRAMEWORK.¹³⁸

Subcontracting:

These types of firms began as small-scale, low capital investment production activities and were based on cost cutting subcontracting relations with Israeli firms since their initiation. They witnessed a fast rate of growth during the initial phases of the occupation period, fueled by the growth in Israeli parent firms. These Israeli firms were able to achieve this growth because of their open access to the markets of the territories and to develop a competitive edge in Israeli and export markets by capitalizing on the low-cost production activities provided by local firms.

Local subcontractors faced negligible difficulties from the occupation authorities because their activities coincided with Israeli policy for local economic development and they functioned completely within the regulatory framework. This factor, combined with a stable, or in some cases, growing source of work, allowed these firms to increase their fixed capital investments in machinery and specialize in the production of specific items. Most moved toward mass production processes but did not develop independent links with local or Israeli markets or with Israeli or local suppliers of raw materials because they obtained all unfinished goods from their Israeli parent firms. Moreover, these firms did not establish links with local firms for services or production activities to complement their work. In fact, the only local links they created were with maintenance sectors, and even these relations were limited, since maintenance was provided by their Israeli suppliers of machinery.

These firms developed rigid production processes relying on specialized machinery. The tasks conducted by these firms were simple and limited to the assembly of prepared components. No high-skilled labor was required for these production processes, and only a limited amount of transfer of skill occurred because of the confinement of workers to repetitive operations along an assembly line system of production.

The increased obstructions by the regulatory framework had no direct impact on the activities of these firms unless they depended on services provided by local sectors that were

¹³⁸ the experience of textile firms could represent the typical response of firms within this category.

blocked by the framework.¹³⁹ As long as their relations with the Israeli parent firms remained stable, they were immune to shifts in Israeli policy. However, these firms were affected by the decline in the local consumption of their final products which were marketed by the Israeli parent firms.¹⁴⁰ As the supply of work from parent firms declined, most of these firms were forced to look for other Israeli firms to subcontract for, in order to fill the gap.

Some of these firms tried to shift their activities to producing finished products for sale in the local markets. They found it difficult to do so for several reasons: they had specialized in the production of very specific items, they had not established connections with local retailers, they not developed an understanding of the local patterns of demand, and they were not linked with suppliers of raw materials because these had been acquired from Israeli parent firms.

Independent Producers:

The regulatory framework allowed the development of firms within certain subsectors, if they did not compete in any way with Israeli producers. The majority of these firms were initiated by wealthy merchant class entrepreneurs who were seen by the authorities as potential partners in the implementation of Israeli government policies in the territories if they were allowed to benefit during the process. The relative ease with which these firms functioned during the initial phases of occupation provided them with enough security to venture into relatively large-scale, fixed-capital intensive production processes that specialized in the manufacture of general consumer goods. These ventures took place if a firm was capable of paying high start-up costs and if there was a stable niche in the local market for the consumption of its products. Otherwise, a firm would be initiated at a small scale.

Firms within this category sought to reduce their reliance on local or Israeli firms for the provision of services or production activities that were required for their final product. However, the unavailability of credit and inadequacy of in-house technical capabilities prevented them from achieving this goal. For this reason, they had to rely on the better endowed Israeli firms for the provision of required services. Local firms were usually unable to provide these because they lacked the capital needed for the introduction of the required high-cost machinery and in some cases, they were prohibited from specific production

¹³⁹ for example, the use of externally owned transport facilities for pick-up and delivery of goods from parent firms.

¹⁴⁰ as a result of the Palestinian uprising.

activities.¹⁴¹ The total reliance of local producers on Israeli firms provided the latter with control over the price, pace and quality of services rendered.

During the initial phases of occupation, firms in this category that functioned within the regulatory framework were able to achieve a relatively high level of independence. Most were able to establish direct links with external sources of raw materials, machinery and technology transfer through their direct use of the Israeli port facilities. As the regulatory framework became increasingly restrictive, they lost such privileges as a result of increased obstruction by Israeli port officials and difficulty in obtaining the required import licenses. Gradually, control over links with external sources transferred to Israeli agents who came to be needed by local firms in order to bypass the newly introduced obstacles.¹⁴²

Thus, the increased restrictions within the framework firmly established Israeli firms, import agents and suppliers of services as integral components of the regulatory framework. The relationship of these additional components with local producers was initially based on commercial factors and continued as long as it was economically feasible for both. However, as relations between the two communities deteriorated, ideological differences came to play an important role.

FUNCTIONING OUTSIDE THE REGULATORY FRAMEWORK:

Production activities that took place in highly restricted subsectors had no alternative but to function outside the regulatory framework.¹⁴³ Most of these types of firms were forced to initiate their activities in small-scale maintenance or flexible production. They relied for the most part on demand patterns in local markets, but were able to gradually gain informal access to Israeli markets. They also benefited from the influx of second-hand appliances which required extensive maintenance operations and allowed them to explore the qualities of these products. They capitalized on access to used machinery for initiating low-cost production activities that allowed experimentation. The intensity of competition with Israeli producers and retailers of competing goods and the limited size of niches in the local and Israeli markets

¹⁴¹ Local firms have on many occasions been obstructed from purchasing specific machinery which would have reduced their reliance on Israeli firms, both by the authorities and the Israeli firms themselves.

¹⁴² since Israeli agents/importers faced no difficulties with port officials or in obtaining import licenses.

¹⁴³ The experience of basic metal firms could represent the typical experiences and the responses of firms within this category.

forced these firms to remain flexible and to vigorously continue exploring new market niches, production processes and additional links with suppliers of raw materials, machinery and technical transfer. The presence of competition by the Israeli modern sector firms forced some of these firms toward competing through innovation rather than price cutting and the sweating of labor.

These firms experienced limited surveillance by the authorities during the initial phases of the occupation, so they were able to develop a flexible and independent foundation for their marketing networks, production processes and access to supplies. They avoided most of the vulnerable links with Israeli providers of services and instead satisfied such requirements locally through diversification of their lines of production or the reliance on other local firms. Their use of second-hand, less advanced production machinery allowed them to develop their technical skills more comprehensively and prepared them for the introduction of modern machinery at a later stage. Their knowledge of local and Israeli markets, sources of raw materials and new and used machinery was further enhanced by information transferred by Israeli employed local workers who came to be employed by these firms as they grew in scale.

Because of their gradual development and their use of low-cost, second-hand machinery, these firms were able to gradually achieve self-sufficiency in most of their lines of production. Their close links with the local firms in the same and other subsectors and their continuous transactions with them led to the parallel development of those sectors. This facilitated the provision of most required services locally. Their reliance on Israeli firms was kept at a minimum and confined to areas where specialized production machinery was required. The high cost of services provided by Israeli firms forced these firms to find local or in-house alternatives, capitalizing on their well developed technical capabilities and inspirations derived through their interaction with Israeli producers.

As the surveillance of informal production activities in the territories and between them and Israel was intensified, most of these firms were gradually forced to function within the regulatory framework or else become confined to an increasingly limited local economy. The acquired skills and distinctive characteristics which they developed while functioning outside the regulatory framework continued to be useful in dealing with fluctuations in market requirements and upgrading their production processes, but did not prove to be particularly effective in dealing with the regulatory limitations that they were unable to bypass. However,

they proved to be less vulnerable to the control exercised by nongovernmental components of the regulatory framework, such as Israeli competing firms, producers, and suppliers of raw materials and machinery, because of the wide range of alternatives that they were able to locate during their initial years. These firms continued to capitalize on their previous informal links in areas that were less monitored by the regulatory framework and thus were able to function between the formal and informal realms very effectively.

6.3 MASS PRODUCTION VS. FLEXIBLE SPECIALIZATION:

Both firm categories discussed in the previous section sought to specialize in the mass production of a few goods. The difference is in the methodology employed by each firm type to reach that goal. Firms that have ventured into mass production since their initiation were able to do so for two reasons: first, these firms faced limited obstruction by the authorities and were able to function within the regulatory framework and capitalize on some of their initial benefits; second, they had a relatively stable source of local demand and the availability of the required start-up capital. These firms were willing to place large fixed capital investments in production activities despite the instability of the overall economic and political conditions. However, some of these firms tried to minimize their initial risk by introducing low-cost second hand machinery and capitalize on the use of family labor during the initial years.

Firms that existed in more restricted subsectors and could not function within the regulatory framework were forced to begin their production activities on a small-scale. The insecurity of functioning outside the regulatory framework prevented them from taking larger risks, even if there was sufficient demand in the local market for a mass production operation. Their decision and ability to expand were directly linked to their ability to construct an alternative framework within which they could function. Their movement toward mass production had to occur gradually with frequent instances of backtracking in response to the frequent alterations in the formal regulatory framework, its surveillance capabilities, and shifts in other economic indicators. Although some of these firms were able to enter into the mass production of a certain product, they always continued the production of other parallel items to reduce the impact of a possible collapse in demand for their main item. The flexible quality of their production processes was maintained and their labor force continued to conduct a wide range of operations and develop its flexible skills in preparation for fluctuations in market

requirements or shifts in the regulatory framework.

The two firm categories responded differently to radical declines in the demand for their main product line. In these situations, firms that maintained a rigid production process and specialized in the production of a specific good, were forced to decrease the scale of their production activities to a minimum and in some cases, were willing to subsidize any losses in their main line of production from other sources of income. This was done in order to avoid a total shut-down of their production processes, which could lead to the loss of highly skilled workers to jobs in Israeli or other local firms, as well as the potential loss of their marketing links. In most cases, these firms resorted to venturing into unrelated branch production or retail operation as an alternative source for the livelihood of the owners and to subsidize the main production plant. Many of these branch income generation activities are maintained alongside the main operation during periods of economic bloom as a back-up option. These branch operations are usually flexible production activities which in some cases have expanded to become the main production activity, replacing the main line of specialized production.

Subcontracting firms that had relied on links with Israeli parent firms and developed rigid mass production processes with limited links to the local economy faced extensive difficulties in making a transition to the production of finished products after the collapse of their links to Israeli parent firms. These firms were unable to efficiently make the transition and diversify their production line in order to respond to the small niches of local demand. They suffered from a lack of in-house expertise for conducting segments of the production activity that traditionally took place at the parent firm. The work force was only capable of conducting specific procedures.

Flexible mass production firms, on the other hand, tend to shift their emphases to their other related lines of production during times of economic slow-down. They will continue the production of their main product in smaller quantities in order to avoid the loss of market links. Their most valuable workers remain employed and are transferred to other related lines of production. Some of these firms have reduced the scale of activity and concentrated on their most viable lines of production during periods of economic slow-down. During these periods, these firms tend to reduce the amount of in-house production operations in order to generate working capital through the sale of some of their machinery and the reduction of their labor force. During these periods, they become more willing to establish extensive subcontracting

links with local firms for acquiring components and services that they have stopped producing.

The increased obstruction by the regulatory framework during the years of the uprising and the decline in consumption by the local population had similar overall impacts on both firm categories. All links to Israeli sources of raw materials, machinery and technology transfer became linked to the ability of local firms to maintain their formal status and continue to function within the regulatory framework. Access for firms located in the Gaza Strip to the markets of the West bank and visa versa became linked to their formal status and additional military permits, which required extensive bureaucratic procedures. In order for a firm to maintain its formal status it had to comply with all the newly introduced restrictive regulations and make payment of all tax estimates despite their illegality or inaccuracy.

In effect, the regulatory framework was transformed into a framework of obstruction of all local economic activities. In order for local firms to function within it, and maintain their essential links to their supplies, they had to pay excessive taxes, abide by extremely limiting restrictions and follow endless procedures for maintaining the extensive numbers of permits and clearances. As an outcome of these developments, a very small number of local firms were able to continue functioning within the regulatory framework. The main factor that contributed to their continued survival was their ability to secure a sizable demand for their products in local markets after the local population began to boycott all Israeli products. This provided them with the required finances to continue the excessive tax payments and tolerate the bureaucratic procedures.

Other firms were forced to limit their links to the local market and its limited supply of raw material, machinery and technology transfer. The flexible firms were able to subsist if their previous links were developed with the local market and were not reliant on Israeli demand. Rigid mass producers that lost their niche in local markets due to the shifts in demand during the uprising (from luxury or non essential goods to basic goods) have in most cases collapsed.

VII CONCLUDING REMARKS:

7.1- The Restructuring of the Palestinian Economy.

7.2- Further Directions.

- . Areas for Intervention.
- . Relevance for Firms Operating under Restrictive Conditions.
- . Relevance for Development Discussion.

7.1 THE RESTRUCTURING OF THE PALESTINIAN ECONOMY:

The general thrust of my thesis has been to show that “control” of the Gaza Strip and the West Bank by the Israeli authorities has constituted not only a political event a the framework within which the economies of the territories have been structurally transformed.

The outcome of Israeli policy toward the economies of the occupied West Bank and Gaza Strip has been the gradual transfer of control over most economic activities to departments of the Israeli government and the sectors of the Israeli economy. Because of amplification of the surveillance apparatus, all Palestinian firms were forced to function within the regulatory framework in order to maintain their vital links the Israeli economy. Through the increased limitations of the regulatory framework, local firms gradually lost their ability to function independently within this framework and were forced to increase their reliance on sectors of the Israeli economy.¹⁴⁴ Attempts to function outside this framework resulted in the confinement of firms to the informal and increasingly limited sectors of the local economy, limited supply of raw materials, machinery and technical transfer and a confined local market.

Firms that continued to operate within the regulatory framework faced two challenges: dealing with the governmental components of the framework and dealing with the sectors of the Israeli economy.¹⁴⁵ Firms that operated within the regulatory framework had to face an increasing obstruction of basic economic activities, increasingly overwhelming bureaucratic procedures, and the full exposure of their operations to the taxation and regulatory departments. After having absorbed most of the income generating activities into the formal regulatory realm through the intensification and personalization of the surveillance process, the Israeli authorities began to tighten the constraints of this framework to achieve three goals: 1. to control the pattern of economic development in the territories and to prevent the establishment of a viable economic base that could represent the Israeli economy with a source of competition or reduce the reliance of the population on Israel;¹⁴⁶ 2. to prevent the independence of action of local firms within the local and Israeli economy and force their reliance on Israeli economic sectors for the provision of a wide range of essential services;

¹⁴⁴ local firms were unable to continue using Israeli port facilities due to increased restrictions. Local producers were not able to introduce certain production machinery or engage in certain production activities and were thus forced to rely on Israeli sectors for the locally unavailable services.

¹⁴⁵ which I considered as the non-governmental component of the regulatory framework.

¹⁴⁶ restrictions on the manufacture of cement, chemicals, dairy products, fertilizers, etc.

3. to increase the government's revenues from both territories in the form of taxation, fines and fees.

Most local firms had to rely on Israeli producers, maintenance sectors, importers of raw materials and machinery, and sources of technology transfer. The increased restrictions within the regulatory framework prevented most local producers from providing such services and from gaining direct access to alternative external sources. The lack of bargaining power in the hands of local firms and the absence of state and legal protection for these firms left Israeli sectors with a strangle hold over the relationships. This imbalance transformed the nature of the relationship between local producers and Israeli economic sectors from one formed by conscious decisions based on economic feasibility for both sides, to one of inequality and exploitation on uneven ground. Furthermore, the increased restrictions within the regulatory framework, in addition to the adverse economic conditions confronting local producers, made the economic feasibility for the Israeli sectors minimal and allowed ideological criteria to dominate this relationship, especially during the years of the uprising and the heightened friction between the Israeli and Palestinian communities.¹⁴⁷

7.2 FURTHER DIRECTIONS:

This research contains the starting point for two future directions of study: the first is a search for appropriate interventions; the second is the integration of this case with the growing literature on industrial restructuring which is taking place in other parts of the world.

Areas for Intervention:

Most local firms have acquired considerable knowledge and skill through their dealings with the governmental and non-governmental components of the regulatory framework and through functioning under particularly adverse economic conditions and in volatile political situations. Some have been able to continue functioning and a few have even grown. Success seems to have been based on the ability to reduce the vulnerability of their relationships with the Israeli economic sectors and to guarantee favorable local market conditions for their particular products. However, the ability of most firms to reduce their vulnerability to the practices of the governmental components of the regulatory framework was very limited, and the potential for achieving that proved to be unrealistic under the current political conditions.

¹⁴⁷ See chapter five, section 5.2.

The study of the activities of these individual firms suggests that during the current phase of occupation, truly beneficial and feasible interventions would address two areas of weakness. First, interventions would target gaps within the services provided by local sectors in order to reduce further dependence on Israeli economic sectors, preferably without causing direct confrontation with the Israeli regulatory framework. Second, they would strengthen the bargaining power of local firms in their dealings with Israeli economic sectors.

ADDRESSING LOCAL GAPS IN SERVICES:

Local importers of raw materials and agents of machinery must play a major role in reducing the reliance of local producers on Israeli suppliers and agents. Even though local agents confront the same difficulties at Israeli port facilities, they could be more effective in dealing with these authorities and maintaining stable relations with external sources of materials and machinery. There are gaps within the local maintenance sector which result in an increased reliance on Israeli maintenance sectors. During the years of occupation, local technicians, workers and firm owners exposed to Israeli modern sector producers and technicians have begun to close these gaps. However, most of the technical knowledge is transferred through informal means and remains informal, thus limiting the potential for further development. There is a shortage in local facilities for technical training and there is no formal access to external sources of technical assistance or technical training programs.

There are two main reasons for gaps in local production processes. The first is the Israeli restrictions on the introduction of specific production machinery and the establishment of certain production activities. The second is lack of capital. Interventions by local and international organizations and attempts by local entrepreneurs to fill the gaps caused by Israeli restrictions have failed. Therefore, proposals for additional attempts could be wasteful, unless new approaches are taken. The closure of gaps that are caused by the lack of capital would be a simpler task for the time being. Some local firms have attempted to fill this gap through the introduction of low-cost, second-hand machinery obtained from Israeli sources. These attempts have faced concerted opposition from competing Israeli firms to the sale of such machinery to local firms.

STRENGTHENING BARGAINING POWER:

The restrictions on the mobility of local producers and agents of machinery and raw

materials prevent the development and maintenance of direct relations between local parties and external suppliers of machinery and materials and formal sources of technology transfer. Organizations located outside the territories could intervene on behalf of local producers and importers. These organizations function as an extension of local agents and producers and could concentrate on the following goals:

- Strengthening relationship between local producers/agents with external producers of raw materials and machinery:
- Establishing links with formal sources of technological transfer and training.
- Exploring external market potentials for local products (Arab, Other).

The most challenging and important interventions would be in areas where the vulnerabilities are a direct result of the Israeli imposed regulatory framework. The ability of local firms or institutions to influence the decisions made by the components of this framework or to question the policy that shapes this framework has been nonexistent. The only instances where such interventions have occurred with some level of success have been when influential international organizations intervened on behalf of local institutions and productive sectors.¹⁴⁸ The involvement of organizations that are independent of Israeli control could provide local organizations and production firms with the required protection against Israeli practices that violate international guidelines on the treatment of the inhabitants of occupied territories. This type of protection is required in a number of areas affecting industrial firms :

- Surveillance of taxation collection practices, establishment of fair tax rates, allocation of revenues generated and a system of appeal.
- Guaranteeing unrestricted access to direct import of raw materials, machinery and technical training and transfer.
- Guaranteeing unrestricted access to direct export to external Arab and European markets.
- Protection of local products through the introduction of tariffs between Israel and the territories.

All interventions should contribute to a two pronged strategy aimed at addressing current needs while in the process laying the foundation for independence. Interventions should therefore try to aid the growth or subsistence patterns that already developed that will form a foundation for development under a more positive political scenario. Addressing the

¹⁴⁸ The EEC support of the direct export of Palestinian agricultural produce.

current requirements should have the priority but the opportunity to establish a foundation should not be postponed.

Relevance to Firms Operating Under Restrictive Conditions:

The material presented here demonstrates that the situation for firms in the occupied territories is rather unique. However, as I conducted my analysis, it has become clear that the strategies in this extreme situation have parallels elsewhere. Looking at the material comparatively, we might say that while the Israeli occupation deliberately makes conditions difficult for local firms in comparison with Israeli firms, the “equal playing field” exists nowhere. Instead, it is common for firms to be shaped by strategies that are unfavorable to them.

Although the situation in the occupied West Bank and Gaza Strip is unique in the nature and extent of restrictive governmental policies and the intensity of the implementation of obstructive guidelines on the activities of industrial firms, a series of lessons could be generated with relevance to the activities of firms in other restrictive situations. Local firms with their wide variety of production processes are subject to a multidimensional test of survival. In order to function, these firms had to develop techniques which allowed them to operate within an extremely restrictive regulatory framework, a set of adverse market conditions, uneven competition with Israeli modern sector producers based in an advanced industrial economy and an unpredictable and ever changing political situation.

Functioning within the increasingly restrictive regulatory framework proved to be difficult for most firms in the Gaza Strip and West Bank. The ability of firms to develop a system which would enable them to function within this framework and reduce their vulnerability to its limitations was very limited. Most local firms were therefore forced to gradually increase their reliance on Israeli economic sectors in order to cope with some of these restrictions and to bypass others. The lessons to be learned are in the systems that local firms developed in order to reduce the vulnerability in their relationships with Israeli economic sectors and in the systems developed to deal with the fluctuating economic conditions and confined markets.

Relevance to Development Discussions:

The restrictiveness of the governmental regulatory framework played the most important role in shaping the characteristics of the production processes employed by local firms. Firms that were able to function within that framework, facing only minor confrontation with the framework, were willing to invest considerable sums of money in rigid/ specialized production lines even though the economic and political conditions were extremely unstable. Once local firms were able to guarantee limited confrontations with the authorities, they addressed the vulnerabilities of their production processes to economic factors. In order to reduce the initial risk of unpredictable market conditions, these firms introduced secondhand machinery and relied on family workers during their early phases of operation. However, most of these firms were not hesitant to specialize in the production of a specific good and to gradually increase their fixed capital investments in that product.

Firms that were unable to function within the highly controlled and restrictive regulatory framework were forced to begin as small-scale and flexible producers and remain that way throughout their existence. The flexible character of their production processes did not change even when some of these firms were able to guarantee a stable market niche for their products. These firms ventured into mass production but maintained the flexible capability of their lines of production in anticipation of increased restrictions within the regulatory framework or unexpected shifts in market characteristics.

Both firm categories, the flexible and the rigid, once forced to function within the regulatory framework, were equally paralyzed by the intensification of restrictions, increased tax rates and tax collection procedures. None of the unique qualities of their production processes provided the ability to continue functioning within this framework. Rather, this ability hinged on the firm's maintenance of a stable market niche and formal links with Israeli suppliers of raw materials, machinery and technical transfer, and on the generation of enough funds for the excessive taxation payments and maintain.¹⁴⁹

The distinctive qualities of the production processes came to play an important role in dealing with the fluctuations of economic conditions, the radical change in the character of Palestinian demand and the obstruction of access to niches in the Israeli markets for local producers during the years of the uprising. In this battle, the clear winners were the flexible

¹⁴⁹ those suppliers began to refuse to offer any extended payment plans on goods and services provided to local producers, especially during the years of the uprising, see chapter five section 5.2.

producers. These firms were able to respond quickly to shifts in local demand and capitalize on the flexible qualities of their lines of production. The nature of their extensive relationships with local markets, acquired through extensive interaction with local retailers and producers, provided them with a better understanding of local demand.¹⁵⁰ The ability of these firms to guarantee a stable access to a niche in the local markets allowed some of them the option of continuing within the regulatory framework and maintaining their formal status.

The inability of local firms to continue functioning within the regulatory framework and the loss of their formal status confined them to the limited informal local market. Even within this confined market, flexible firms were also able to achieve better results than their rigid and specialized counterparts. While this confinement reduced most of these flexible firms into subsistence production activities, it caused the total collapse of the rigid producers. The flexible firms responded to the confinement to a small informal local market by reducing their scale of production and number of workers and increasing their reliance on subcontracting relations with local firms. The majority sold off some of their machinery to local firms that they established subcontracting relationships with, to reduce their fixed capital investments and generate more working capital.¹⁵¹ Most of the rigid producers were forced to abandon their production activities altogether if there was no demand for their particular products within the local informal markets. Many of these firms ventured into branch flexible production activities, usually unrelated to their original lines of production, or engaged in other income generation activities such as direct employment.

As is clearly evident from this study, most local firms flexible or rigid producers aspired to specialize in the mass production of a limited number of general products but have approached this goal through different processes. Firms that were established within less restricted subsectors and which anticipated limited confrontations with the regulatory framework ventured into the mass production of specific goods at the initial phases of their establishment. To reduce the initial shock that could be caused by the unpredictable fluctuations of the economy and the shifts or limitations of local demand, most introduced low-cost secondhand machinery and relied on family labor during the critical trial period. Most

¹⁵⁰ *(as a result of the nature of their operations, these firms established extensive relationships with local producers through subcontracting out and retailers, through their production and sale of a wide range of products that mostly targeted local demand)

¹⁵¹ The availability of working capital declined considerably as a result of the decline in sales during the uprising and the collapse of their access to deferred payment plans on their required raw materials.

expanded, introduced modern machinery and shifted to the use of external wage workers as their footing in the local market became more grounded and their familiarity with the limitations of the regulatory framework was developed.

Firms that were established in the more restricted subsectors and anticipated confrontations with the regulatory framework, were forced to introduce small-scale, flexible production processes for the provision of customized services or the manufacture of batches of a wide range of related products. Their decision to initiate their activities at the small scale flexible level was influenced by their expected confrontations with the authorities and the limited market potentials for their products due to an intense competition by Israeli producers and importers. Their scale of production expanded gradually as they were able to develop an effective system of by passing Israeli restrictions and after having guaranteed stable access to local market niches. Some were able to expand into the mass production of one of their more successful products but maintained the flexible nature of their production processes and continued producing related goods in anticipation of a decline in economic factors or shifts in the Israeli restrictive policies. Most of these firms were only able to make the shift to mass production after being forced to formalize their activities and operate within the regulatory framework. At that point, many of these firms were unable to continue making the exorbitant tax payments, fines, and fees unless they had achieved economies of scale in their main line of production.

The economic strategies of “flexible specialization”, “family ownership”, “subcontracting” and “residential setting” of manufacturing activities are coming to be seen as characteristic small-firm strategies in response to economic and often regulatory restrictions. It does turn out that there is potential for building comparatively on this “particularly extreme case” and joining it to a larger discussion on economic restructuring.

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